

Exhibit 23

City Hall pension politics heat up

Plan to scrap board may prove tricky for Murphy

By Philip J. LaVelle
STAFF WRITER

July 4, 2004

Culprit, or champion of the little guy?

These competing views of the governing board of San Diego's troubled pension system are in play at City Hall, framing a debate that threatens to put elected officials there in a tight spot while complicating Mayor Dick Murphy's life in an election year.

At issue: a recommendation by Murphy's Pension Reform Committee to scrap the San Diego City Employees Retirement System board and replace it with a panel of appointed financial professionals.

The goal: to eliminate potential conflicts of interest on a board that over eight years has endorsed City Hall's contradictory fiscal policy of boosting benefits while underfunding the retirement system.

The current majority of the 13-member pension board includes people with a direct financial stake in benefit hikes: city employees, managers, union representatives and a retiree.

"I really believe that the problems we face today we would not have had — had we had a truly independent board," Dick Vortmann, a pension trustee and Pension Reform Committee member, told the City Council's Rules Committee on Wednesday.

But labor leaders and city employees say tradition and democratic principles argue in favor of giving current and former city workers a continued say in who oversees their retirement nest eggs.

"Are you willing to put your retirement in the hands of a political appointee who you've never voted for?" Water Department chemist Josie Hill told the Rules Committee, echoing the discomfort of rank and file.

Municipal Employees Association President Judie Italiano, who leads City Hall's largest labor union, opposed the board change as a member of the Pension Reform Committee. Acknowledging problems at the pension system, Italiano told the Rules Committee that the existing system has nonetheless worked well for 77 years and is the "envy" of public pension systems

Proposed retirement board

■Seven appointed by City Council.

Qualifications: College degree and/or professional certification; 15 years experience in pensions, investment management, banking or certified public accounting. Must be U.S. citizens and San Diego residents.

Ineligible: City employees and direct family members; union representatives; anyone whose "other personal interests" constitute or create appearance of conflict of interest with duties of pension trustee.

Source: Pension Reform Committee

nationwide.

Time is critical: The City Council has just over four weeks to meet an early August deadline to put this and two other pension-related changes to the City Charter on the Nov. 2 ballot.

Members of the Rules Committee – all of whom enjoy some measure of union backing at election time – voted Wednesday to delay for two weeks a vote on whether to send the matter to the full council. Murphy, chairman of the Rules Committee, said he hoped to find a compromise acceptable to both sides.

Pension Reform Committee Chairwoman April Boling said she is open to compromise but views this as an early test of City Hall's commitment to fixing the problem.

"If nothing goes on the ballot and the council agrees that the status quo with the retirement board is acceptable, that's a pretty good indication that they're not serious about pension reform," Boling said in an interview.

If the board composition does change, it would put San Diego in unique territory.

Joan Raymond, president of Local 127 of the American Federation of State, County and Municipal Employees, said the overwhelming majority of America's public pension systems have employee representation. "Employees should have a say in how pension funds are spent or invested," she said.

Boling argued that because the city pours in the lion's share of annual contributions, the council should appoint who oversees the system. The pension system is straining under a \$1.15 billion deficit and unfunded retiree health care costs that could approach \$1 billion.

Other Pension Reform Committee members said conflicts at the pension board have driven bad decisions spanning nearly a decade. But pension board President Frederick W. Pierce IV said conflicts exist "only in perception" and that participation of employee and management trustees is "absolutely invaluable."

The pension situation figures heavily in downgrades of the city's credit ratings and an investigation of city finances by the FBI and Securities and Exchange Commission. With these investigations unresolved, the city's ability to raise cash for short-and long-term borrowing in the bond markets is crippled.

The pension deficit is due to a mix of benefit hikes; years of underfunding, done to free cash for city operations; and investment losses in 2000-02.

Two underfunding deals pushed by city officials, in 1996 and 2002, had to be endorsed by the pension board. Former City Manager Jack McGrory, who engineered the 1996 deal, advocates "a clean sweep" of the board.

Disputed board

Critics want to change the makeup of the San Diego city pension board, which they say has inherent conflicts of interest because some members have a direct stake in the level of retirement benefits.

Current retirement board:

- Three elected by general city workers.
- One elected by the firefighters union.
- One elected by the police union.
- One elected by retirees.
- Three "ex officio" members: city manager; city treasurer; city auditor.
- Four members, including one local banker, who must be San Diego residents, appointed by City Council.

Source: San Diego City Employees Retirement System

"I don't think anybody who has a direct financial stake in the outcome should be a member of that board," McGrory said in an interview. "The question is, is the council ready to buck the employee organizations on this type of change? It puts them all (Murphy and the council) in a very tight spot. The employee organizations have tremendous influence at City Hall."

Union clout was in evidence at the Rules Committee hearing. One Municipal Employees Association board member prefaced his remarks to the panel with a reminder that he had campaigned for three of them.

Meanwhile, Councilman Scott Peters, seeking re-election in District 1, seemed to lean in favor of a plan advanced by Ron Saathoff, president of San Diego Firefighters Local 145. Peters quizzed board member Vortmann for "facts" showing how the board composition has hurt pension finances.

Saathoff, a longtime pension board trustee at a time of generous benefit hikes for firefighters, voted for the 1996 and 2002 underfunding deals.

"The problem is not the board," Saathoff told the Rules Committee. "The problem is raids by government" on the pension fund. He suggested tougher City Charter language to ban underfunding deals.

In an interview, Peters said: "I really don't have a strong opinion on the board's composition. I have a question about whether changing the board composition really addresses the issues."

The firefighters spent nearly \$30,000 in independent expenditures on Peters behalf in 2000 and saturated his district with yard signs in the March primary. Asked if that backing colors his decision making, Peters said the only pressure he feels is from voters who want him "to fix the problem."

The pension board is comprised of three members elected by general city employees; one elected by police; one elected by firefighters; one elected by retirees; the city manager, city treasurer and city auditor; and four citizens appointed by the City Council.

Board members serve six-year terms with no term limits. The manager, treasurer and auditor serve "ex officio," or by virtue of their positions.

Vortmann, president of the National Steel and Shipbuilding Co., drafted language for a new board, to consist of seven veteran financial professionals appointed by the council. They would serve up to two four-year terms and must be free of real or perceived conflicts.

"There certainly is the appearance of a potential conflict, if not the reality," Vortmann said of the current board makeup.

He said he was "incensed" in 2002 that a benefit deal between city management and labor was made contingent on retirement board approval.

"You have people from management administering things that they are negotiating from their side, and you have union people doing likewise," Vortmann said. "It puts those individuals in a very difficult position. I wouldn't want to be one of them, myself."

»Next Story»

Find this article at:

http://www.signonsandiego.com/uniontrib/20040704/news_1m4pension.html

☐ Check the box to include the list of links referenced in the article.

© Copyright 2007 Union-Tribune Publishing Co. ? A Copley Newspaper Site

THE CITY OF SAN DIEGO, CALIFORNIA
MINUTES FOR REGULAR COUNCIL MEETING
OF
MONDAY, JULY 19, 2004
AT 2:00 P.M.
IN THE COUNCIL CHAMBERS - 12TH FLOOR

Table of Contents

CHRONOLOGY OF THE MEETING.....	3
ATTENDANCE DURING THE MEETING	3
ITEM-1: ROLL CALL.....	4
ITEM-10: INVOCATION	4
ITEM-20: PLEDGE OF ALLEGIANCE.....	4
ITEM-30: Return to Normandy Day.....	4
ITEM-31: Prosecutors of the Year 2003 Award	5
CLOSED SESSION.....	6
* ITEM-100: Contract Change Order No. 1 for Additional Funding for Sewer Pump Station 19..	8
* ITEM-101: Fourth Amendment to Consultant Agreement with Helix Environmental Planning, Inc., for State Route 905 Environmental Documents	10
* ITEM-102: Phase Funded Consultant Agreement with URS Corporation for Coastal Rail Trail Design	12
* ITEM-103: Subdivision Off-Site Right-of-Way and Easement Acquisition Agreement with Western Pacific Housing McGonigle Canyon, LLC (Developer) for Construction of Carmel Valley Trunk Sewer	14
ITEM-104: Initiating a Community Plan Amendment to Increase the Total Average Daily Trips to Accommodate Community Center/YMCA at Torrey Hills Neighborhood Park	16
* ITEM-105: Initiating Community Plan Amendment to Relocate the Fire Station No. 47 in the Pacific Highlands Ranch Subarea Plan in the Carmel Valley Community	17

Minutes of Monday, July 19, 2004
Table of Contents (Continued)

Page 2

* ITEM-106: Initiating Community Plan Amendment to Relocate the Fire Station No. 48 in the Black Mountain Ranch Subarea of the Rancho Penasquitos Community Planning Area.....	18
* ITEM-107: Letter of Intent Between the Cities of San Diego and Chula Vista regarding Property Reorganization within the Otay Valley Regional Park Planning Area..	20
* ITEM-108: Reappointments to the La Jolla Shores Planned District Advisory Board	21
* ITEM-109: James Hill Day	22
ITEM-200: Fiscal Year 2004-2005 Appropriation Ordinance.....	22
ITEM-201: Pension Obligation Bonds.....	23
ITEM-250: SUBMISSION OF BALLOT PROPOSALS.....	24
ITEM-251: ARGUMENTS SUPPORTING OR OPPOSING PROPOSITIONS.....	25
* ITEM-S400: Declaring a Continued Local Health Emergency Due to the Spread of the Hepatitis C Virus and the Human Immunodeficiency Virus (HIV)	26
ITEM-S401: In the Matter of Information Report Update on FY 2004 – 2005 State Budget.	26
ITEM-S402: Seven actions related to submitting to the voters various ballot propositions relating to recommendations from the Pension Reform Committee	27
NON-DOCKET ITEMS	30
ADJOURNMENT.....	30

(Continued from the meeting of July 12, 2004, Item S401, at the request of Councilmember Madaffer for further review.)

FILE LOCATION: NONE

COUNCIL ACTION: (Time duration: 2:49 p.m. – 2:49 p.m.)

MOTION BY FRYE TO CONTINUE TO JULY 26, 2004 FOR FURTHER REVIEW BY THE CITY MANAGER. Second by Peters. Passed by the following vote: Peters-yea, Zucchet-yea, Atkins-not present, Lewis-yea, Maienschein-yea, Frye-yea, Madaffer-not present, Inzunza-yea, Mayor Murphy-yea.

ITEM-S402: Seven actions related to submitting to the voters various ballot propositions relating to recommendations from the Pension Reform Committee.

(See City Manager Reports CMR-04-154 and 04-143; memorandum from Charles G. Abdelnour dated 6/28/2004; memorandum from Mayor Murphy dated 7/7/2004; and memorandum from the City Attorney dated 6/25/2004. The following were not available at Committee: memorandum from the City Attorney dated 7/16/2004 and memorandum from the Pension Reform Committee dated 6/9/2004.)

TODAY'S ACTIONS ARE:

Consider introduction and adoption any or all of the ordinances in Subitem A, Subitem B and Subitem C. **NOTE:** As an option, Subitem D could be introduced and adopted. Subitem D combines the issues contained in Subitems B and C, and therefore should be considered only if both Subitems B and C are not adopted.

Subitem-A: (O-2005-11) INTRODUCED AND ADOPTED AS
ORDINANCE O-19299 (New Series)

Introduction and adoption of an Ordinance submitting to the qualified voters of the City of San Diego at the Municipal Election consolidated with the Statewide General Election to be held on November 2, 2004, one proposition amending the City Charter by amending Article IX, Section 143 regarding City contributions to the Retirement System.

Subitem-B: (O-2005-12) INTRODUCED AND ADOPTED AS AMENDED AS

ORDINANCE O-19300, WITH DIRECTION (New Series)

Introduction and adoption of an Ordinance submitting to the qualified voters of the City of San Diego at the Municipal Election consolidated with the Statewide General Election to be held on November 2, 2004, one proposition amending the City Charter by amending Article IX, Section 144 and amending Article X, all regarding the composition of the Retirement Board.

Subitem-C: (O-2005-14) FAILED

Introduction and adoption of an Ordinance submitting to the qualified voters of the City of San Diego at the Municipal Election consolidated with the Statewide General Election to be held on November 2, 2004, one proposition amending the City Charter by amending Article IX to add Section 144.1 regarding the processing of disability retirement determinations by the Retirement Board.

Subitem-D: (O-2005-13) NOTED AND FILED

Introduction and adoption of an Ordinance submitting to the qualified voters of the City of San Diego at the Municipal Election consolidated with the Statewide General Election to be held on November 2, 2004, one proposition amending the City Charter by amending Articles IX, Section 144 and amending Article X, all regarding the composition and authority of the Retirement Board.

Subitem-E: DIRECTION GIVEN

In the matter of Council direction regarding the City Attorney's impartial analysis on any or all of the ballot measures approved for placement on the ballot.

Subitem-F: DIRECTION GIVEN

In the matter of Council direction regarding the City Manager's fiscal analysis of on any or all of the ballot measures approved for placement on the ballot.

Subitem-G: DIRECTION GIVEN

In the matter of Council direction regarding authorship of ballot arguments for any or all of the ballot measures approved for placement on the ballot.

**RULES, FINANCE AND INTERGOVERNMENTAL RELATIONS COMMITTEE'S
RECOMMENDATION:**

On 7/14/2004, RULES voted 4 to 0 to:

- A. Approve the Pension Reform Committee's recommendation #1 (regarding amortization costs) as amended by the Mayor's proposal and as amended by Councilmember Peters' language submitted today.
- B. Forward the Pension Reform Committee's recommendation #2 (regarding disability hearings) to the full City Council without a recommendation.
- C. Adopt the Mayor's proposal to amend Charter Section 144 with two changes: 1) Change 10 years experience to 15 years experience and 2) stagger the 4-year terms.

Along with these motions, the Rules Committee directed the City Attorney to bring to the full City Council an explanation of the pertinent legal issues involving these proposals and to consult with our litigators to make sure these proposals are consistent with the Gleason case settlement. (Councilmembers Peters, Maienschein, Madaffer, and Mayor Murphy voted yea. Councilmember Atkins not present.)

FILE LOCATION: MEET

COUNCIL ACTION: (Time duration: 3:50 p.m. – 7:21 p.m.)

MOTION BY ZUCCHET TO INTRODUCE, DISPENSE WITH THE READING, AND ADOPT THE ORDINANCES AS AMENDED TO AMEND THE ORDINANCE IN SUBITEM B, PAGE 3 OF 10, SUBSECTION (f) TO READ "ONE CITY MANAGEMENT EMPLOYEE IN THE ADMINISTRATIVE SERVICE APPOINTED BY THE CITY MANAGER TO SERVE AT THE PLEASURE OF THE CITY MANAGER." DIRECT THAT THE SENTENCE APPEARING IN THE ARIZONA STATE RETIREMENT SYSTEM STATUTE, PAGE 14, SUBSECTION (D)(1), "A PERSON WHO IS A STOCKBROKER OR BOND BROKER AND WHO IS ACTIVELY ENGAGED IN THE PROFESSION OF A STOCKBROKER OR BOND BROKER" BE INCLUDED AS PART OF THE CITY ATTORNEY'S INTERPRETATION AND IMPARTIAL ANALYSIS IN THE BALLOT. Second by Peters. Passed by the following vote: Peters-yea, Zucchet-yea, Atkins-not present, Lewis-yea, Maienschein-yea, Frye-nay, Madaffer-not present, Inzunza-yea, Mayor Murphy-yea.

MOTION BY PETERS TO INTRODUCE, DISPENSE WITH THE READING, AND ADOPT THE ORDINANCE IN SUBITEM C. Second by Maienschein. Failed by the following vote: Peters-yea, Zucchet-nay, Atkins-not present, Lewis-not present, Maienschein-yea, Frye-nay, Madaffer-not present, Inzunza-yea, Mayor Murphy-yea.

MOTION BY MAIENSCHIEIN THAT THE CITY COUNCIL REQUIRE THE CITY ATTORNEY'S IMPARTIAL ANALYSIS ON ANY OR ALL OF THE BALLOT MEASURES APPROVED FOR PLACEMENT ON THE BALLOT IN SUBITEM E; REQUIRE THE CITY MANAGER'S FISCAL ANALYSIS ON ANY OR ALL OF THE BALLOT MEASURES APPROVED FOR PLACEMENT ON THE BALLOT IN SUBITEM F; AND, IN CONJUNCTION WITH THE PENSION REFORM COMMITTEE, TO DELEGATE THE WRITING OF THE BALLOT ARGUMENT IN FAVOR TO THE MAYOR'S OFFICE FOR ANY OR ALL BALLOT MEASURES APPROVED FOR PLACEMENT ON THE BALLOT IN SUBITEM G. Second by Zucchet. Passed by the following vote: Peters-yea, Zucchet-yea, Atkins-not present, Lewis-not present, Maienschein-yea, Frye-yea, Madaffer-not present, Inzunza-yea, Mayor Murphy-yea.

NON-DOCKET ITEMS:

None.

ADJOURNMENT:

The meeting was adjourned by Mayor Murphy at 7:58 p.m.

FILE LOCATION: MINUTES

COUNCIL ACTION: (Time duration: 7:57 p.m. – 7:58 p.m.)

Measures to fix city pension plan OK'd | New language may force out a trustee

[1,7 Edition]

The San Diego Union - Tribune - San Diego, Calif.

Author: Philip J. LaVelle

Date: Jul 20, 2004

Section: LOCAL

Text Word Count: 1005

Document Text

The San Diego City Council voted yesterday for a string of measures aimed at repairing a battered pension system -- including one with language inserted at the last minute that could boot a whistle-blower from the retirement board.

The action came as part of a broader package of votes, including approval of borrowing "at least" \$200 million to begin paring back a \$1.15 billion pension deficit at the \$3.2 billion San Diego City Employees Retirement System.

The council also approved two ballot measures -- one calling for the pension debt to be paid off in 15 years and banning future underfunding by the city, the other calling for a restructured pension board.

A third proposed ballot measure, dealing with disability retirements, was voted down.

The measure to change the retirement board was rejiggered prior to the meeting by Mayor Dick Murphy, who boosted union representation from earlier proposals, making the package vastly different from the smaller board, of financial professionals free of conflicts of interest, suggested by a majority of Murphy's own Pension Reform Committee.

Yesterday during council discussion, language was added to this measure by Councilman Michael Zucchet, a former firefighters' union lobbyist, that could ban investment advisers, or people who sell stock, bond or real estate investments from serving on a new board.

This would prevent trustee Diann Shipione, who has long warned of the dangers of underfunding the pension fund, from serving.

Shipione is vice president of investments at UBS Financial Services, and since 2002 has sounded sharply worded warnings -- most of them ignored -- to the mayor and council against underfunding the pension system.

Her actions have drawn national media attention to San Diego's pension crisis while turning her, not surprisingly, into a virtual pariah at City Hall.

"There are people who really want me off this board," Shipione said in an interview after the meeting. "Maybe part of their deal is to get me off. I don't blame them."

The ballot measures go to voters in November.

Zucchet's last-minute language will not appear on the actual ballot measure. Instead, it will appear in the city attorney's published analysis of the ballot measure, stating that it is the council's intent that financial advisers be banned.

Zucchet said he wanted "a little bit of a step up" from the ballot language banning trustees from having financial interests in the system.

He said his concerns were aimed at the hypothetical situations of "a principal at AG Edwards who may bring a bias to the board to invest in stocks and bonds, or a real estate developer who would come to the board who may not have an interest in a piece of property controlled by the retirement board, but would have a general interest in the retirement board getting more involved in real estate transactions."

Composition of the board was the most controversial of yesterday's actions.

The Pension Reform Committee had recommended a dramatic restructuring of the retirement board. Gone would be anyone with even a perceived conflict of interest, replaced by a leaner board of seven veteran financial professionals with no personal stake in pension decisions.

Currently, the 13-member board has a majority of city employees, management and a retiree.

Last week, the council's Rules Committee approved a Murphy compromise calling for an 11-member board, with a thin, one-vote majority of six financial professionals. The minority would include three employee representatives, a manager and a retiree.

Yesterday Murphy announced that he had tinkered with that structure, unveiling a plan that in some ways looked a lot like the current board.

Murphy's new compromise: A board with 13 members, with a seven-member majority of financial professionals who are not among those banned from serving. The minority would include one member elected by police officers, one elected by firefighters, two elected by non-public-safety employees, one elected by retirees and a manager.

"I'm hoping this will bring some consensus to what has been a completely fractured effort to move forward," Murphy said. "No good deed goes unpunished. I have caught flak from everybody involved in this."

Union leaders praised it as a workable compromise. Several Pension Reform Committee members expressed reservations that their original plan had been watered down.

The \$200 million pension bond, to be paid off over 30 years, passed with Councilwoman Donna Frye opposed.

The ballot measure reducing the pay-down time of the deficit and calling for no more underfunding passed unanimously.

The ballot measure to restructure the pension board passed with Frye opposed. She said the council was rushing to action in an election year. Murphy and Councilman Scott Peters are in re-election battles.

"I think everybody's in a big rush to do something and quick-fix it," Frye said. "I think it needs a longer discussion and I don't know that this is going to solve what's ailing the retirement system."

Council members Toni Atkins and Jim Madaffer were absent from yesterday's meeting.

How far yesterday's actions go toward reforming the pension system remains to be seen.

In addition to the \$1.15 billion deficit, the system has unfunded retiree health-care costs approaching \$1 billion.

The deficit is attributed to eight years of pension system underfunding by the city; benefit hikes; and the stock market downturn of 2000-2002.

The crisis has made it certain the retirement system will gobble up huge chunks of city budgets for years to come -- this year the council poured a record \$130 million into the system -- and figures heavily in federal investigations of city finances and downgrades in the city's credit ratings.

The outcome of the ballot measures is necessarily a question mark, to be decided by San Diego voters on Nov. 2.

Selling the pension bonds, meantime, is for now a murky proposition. The FBI and Securities and Exchange Commission investigations cast an air of uncertainty over city finances, crippling the city's ability to raise cash through bond sales.

Murphy has said he hopes the city will be able to re-enter the bond markets within six months.

Credit: STAFF WRITER

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

Abstract (Document Summary)

The council also approved two ballot measures -- one calling for the pension debt to be paid off in 15 years and banning future underfunding by the city, the other calling for a restructured pension board.

[Diann Shipione] is vice president of investments at UBS Financial Services, and since 2002 has sounded sharply worded warnings -- most of them ignored -- to the mayor and council against underfunding the pension system.

The ballot measure to restructure the pension board passed with [Donna Frye] opposed. She said the council was rushing to action in an election year. [Dick Murphy] and Councilman Scott Peters are in re- election battles.

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

San Diego's Pension Crisis**Tawdry display****City pension board changes would snag critic**

July 21, 2004

Long before the mismanagement of the municipal pension fund erupted into a full-scale crisis threatening to destroy San Diego's financial standing, a lone voice warned repeatedly about the emerging folly. But Mayor Dick Murphy and the City Council spurned the prescient pleas of Diann Shipione, a La Jolla investment adviser who serves on the city's retirement board.

Now that her dire admonitions have materialized -- amid a federal criminal probe of the city's pension dealings and a costly downgrading of its credit rating -- the City Council has moved to silence Shipione. In what smacks of political vengeance, Murphy and a council majority voted this week to ban investment advisers from the pension board. Shipione, whose tenacious whistle-blowing has made her persona non grata at City Hall, is an investment adviser.

The author of the provision to ban investment advisers was Councilman Michael Zucchet. He denies his action was directed against Shipione, who is widely known as the investment expert who challenged the City Council's reckless policy of deliberately underfunding the pension system while simultaneously expanding benefits to lavish levels. "I had no idea, until I read it in the paper this morning, what Diann Shipione does for a living," declares Zucchet.

Maybe so. The truth is that the City Council remains in denial that the pension debacle is a very grave matter, and that fundamental reform is imperative to avert a meltdown of the general fund.

That the council still doesn't get it is clear from the way it shunned the Pension Reform Committee's call for an independent retirement board free of the glaring conflicts of interest that have contributed to the crisis at hand. Under the current arrangement, nine of the board's 13 trustees are vested members of the very pension fund they administer. Their votes to enhance their own personal retirement checks compromise the integrity of the board.

Yet instead of endorsing a panel composed of seven professionally qualified trustees who have no personal stake in their own actions, as the Pension Reform Committee urged, the council voted to retain a 13-member board, with seven independent members and six representatives of the city's powerful public employee unions and vested retirees. And, of course, the expertise of investment advisers would be barred.

Some have suggested the council's shameless assault on Shipione was part of a cynical bid to derail a measure headed for the November ballot to overhaul the retirement board. Zucchet's provision ousting Shipione was included at the last minute of the council's debate over putting the proposition before voters. If in fact voters reject the watered-down reform measure, it would preserve the status quo -- thereby perpetuating the glaring conflicts that leave the public employee unions in full control of the pension board.

Find this article at:<http://www.signonsandiego.com/news/metro/pension/20040721-667-tawdrydi.html>

☐ Check the box to include the list of links referenced in the article.

© Copyright 2007 Union-Tribune Publishing Co. ? A Copley Newspaper Site

CITY OF SAN DIEGO

Proposition H

(This proposition will appear on the ballot in the following form.)

PROP H AMENDS THE CITY CHARTER TO CHANGE THE COMPOSITION OF THE RETIREMENT BOARD. Shall the Charter be amended to change the composition of the Retirement Board as follows: seven highly qualified citizen appointees without interests in the City's pension system, four members elected from classifications of active membership (one police, one fire, two general), one member elected from the ranks of the retired, and one member appointed by the City Manager from City management?

This proposition requires approval by a majority (over 50%) of the voters.

Full text of this proposition
follows the arguments.

CITY ATTORNEY'S IMPARTIAL ANALYSIS

The City Council has authorized the placement of a proposition on the ballot seeking voter approval to amend Article IX, section 144 and Article X, section 7 of the City Charter to change the composition of the City's Retirement Board and change the qualifications for appointment to the Board.

Under the current Charter, the Board is composed of thirteen members: the City Manager, the City Auditor and Comptroller, the City Treasurer, three members elected by the active general membership, one member elected from City retirees, one member elected by the active membership from Fire Safety, one member elected by the active membership from Police Safety, and four citizens appointed by the Council, one of whom must be a local bank officer. The Charter prescribes six-year terms for Board members.

Voter approval of this measure would maintain the total number of Board members at thirteen, but change the terms of office to four years and change the composition of the Board as follows: seven citizens with professional qualifications appointed by the Council, two members elected by the active general membership, one member elected from City retirees, one member elected by the active membership from Fire Safety, one member elected by the active membership from Police Safety, and one top ranking City management employee appointed from the administrative service of the City.

The measure includes qualifications for the citizen appointees to the Board. The seven citizen appointees must have a college degree in finance, economics, law, business, or other relevant field of study, or a relevant professional certification. Additionally, a citizen appointee must have a minimum of fifteen years experience in pension administration, pension actuarial practice, investment management, real estate, banking, or accounting.

The measure also contains qualifications for citizen appointees in order to prevent conflicts of interest. First, "no person who is a City employee, participant in the Retirement System, or City union representative may be eligible for appointment in this category." Second, "appointees shall not have any other personal interests which would create a conflict of interest with the duties of a Board member and trustee." At the Council hearing regarding placement of the measure on the ballot, the City Attorney interpreted this language with more specificity and obtained Council concurrence to verify the Council's intent. A "participant" in the Retirement System is a person who has assets invested with the Retirement System or who is designated as a beneficiary for someone with assets invested in the Retirement System. A "personal interest" that conflicts with Retirement Board duties means an income interest that is reportable on a Statement of Economic Interests in the City, the Retirement System, or any entity contracting as a plan sponsor with the Retirement System. A person who is a "participant" or who has a "personal interest" is not eligible for appointment to the Board as a citizen appointee. Additionally, a stockbroker or bond broker actively engaged in doing business with the City or the Retirement System is ineligible for appointment.

CITY MANAGER'S FISCAL ANALYSIS

The effect of this proposition changes the composition of the Retirement Board, requiring seven of the thirteen members to be professionals with at least fifteen years experience in related fields, and with no personal or professional stakes in the Retirement System. No board members receive compensation to serve on the Retirement Board.

The proposed ballot measure to change the composition of the Retirement Board carries no fiscal impact.

ARGUMENT IN FAVOR OF PROPOSITION H

Vote YES on Proposition H to protect your tax dollars.

Vote YES on Proposition H to safeguard the City Retirement system.

Vote YES on Proposition H for an independent professionally qualified City Retirement Board.

Proposition H is the result of recommendations made by the Pension Reform Committee which was established by the Mayor and City Council to review the City's pension system and make recommendations for reform and change.

Currently the 13-member Retirement Board has nine (9) members who represent City management and employees and four (4) outside independent members.

The Pension Reform Committee recommended a seven (7) member board with no representatives from City employees or City management. After hearing public testimony, the City Council agreed that the majority of the Retirement Board should be independent professionally qualified members but that City management and City employees should also be represented. That's fair.

Proposition H accomplishes that goal. Independence and fairness.

A YES vote on Proposition H will change the existing Retirement Board from having a majority of City employees and City managers to a Board having a majority of independent professionally qualified outside members. There will be seven outside members and six City management-City employee members on the new Retirement Board.

A YES vote on Proposition H will also establish tough professional and ethical qualifications for appointments to the Retirement Board that will enhance the ability of the Board to professionally manage the City's pension fund.

Proposition H specifically says persons appointed to the Retirement Board "shall not have any other personal interests which would create a conflict of interest with the duties of a Board member and trustee."

A YES VOTE ON PROPOSITION H WILL PROTECT TAXPAYERS, CITY EMPLOYEES AND CITY RETIREES.

Endorsed by the Pension Reform Committee!!

APRIL BOLING
Chair,
Pension Reform Committee

LISA BRIGGS
Executive Director,
San Diego County Taxpayers Association

DICK MURPHY
Mayor
City of San Diego

ARGUMENT AGAINST PROPOSITION H

Our Pension System is **underfunded by over a billion dollars**. It is irregularly managed by the Pension Board and irregularly funded by the Mayor and City Council majority. Real funding and management changes need to occur. This measure **does nothing** to solve the underfunding or management problems.

If we do not correct both the underfunding and management problems soon, it will exacerbate the City's current debt. This could **result in cuts in safety** and environmental services, and **limit our ability to fund** recreation activities and **basic neighborhood services**.

This proposal addresses **none** of these problems.

The latest underfunding proposals voted through the Pension Board were **opposed** by both a public representative **and** a labor representative. Most of the "Public Representatives" on the board voted to continue the underfunding.

The problem isn't who sits on the board. The problem is the **private underfunding agreements** and **deals that occur behind closed doors**, before the Pension Board ever meets.

A majority of the Pension Board Members that voted for underfunding the last time are **still eligible to serve** under this measure. Where is the reform in that?

We all agree that reform of the Pension System is needed. This proposal suggests that reshuffling a few seats on the Pension Board from labor representatives to public representatives will somehow solve the problem. It is only a ruse to give the impression of a solution, when it **clearly does nothing to solve the real problem**.

Please Vote NO!

DONNA FRYE
San Diego City Councilmember

DIANN SHIPIONE
Pension Board Trustee
(Public Representative)

PROPOSED CHARTER AMENDMENT

(The portions of the charter to be added are underlined
and the portions to be deleted are printed in ~~strike-out~~ type.

Section 144: Board of Administration

~~The system shall be managed by a Board of Administration which is hereby created, consisting of the City Manager, City Auditor and Comptroller, the City Treasurer, three members of the Retirement System to be elected by the active membership, one retired member of the retirement system to be elected by the retired membership, an officer of a local bank, and three other citizens of the City, the latter four to be appointed by the Council. Such appointees shall serve without compensation. Members of the Board, other than ex officio, shall serve six years or until their successors are elected and qualified, and shall so classify themselves by lot that one term shall expire each year. The members of the existing Board shall serve out their unexpired terms.~~

~~The Board of Administration may establish such rules and regulations as it may deem proper; shall elect one of its members president and appoint a secretary and may appoint such other employees as may be necessary. Such appointments, except the actuary, shall be made under the provisions of Article VIII of this Charter.~~

~~The Board of Administration shall be the sole authority and judge under such general ordinances as may be adopted by the Council as to the conditions under which persons may be admitted to benefits of any sort under the retirement system; and shall have exclusive control of the administration and investment of such fund or funds as may be established; and shall be permitted to invest in any bonds or securities which are authorized by General Law for savings banks; and, further, shall be permitted to invest in such additional classes or types of investments as are approved by resolution of the Council of The City of San Diego; provided, however, that individual investments within the classes or types approved by the Council must be approved by independent investment counsel; and, provided, further, the board may place such funds in the hands of the Funds Commission for investment. Provided, however, that the Auditor and Comptroller shall refuse to allow any warrant drawn for payment of a retirement allowance if, in the opinion of the Auditor and Comptroller, such retirement allowance has been granted in contravention of this Article or any ordinances passed under the authority granted herein.~~

Effective April 1, 2005, the system shall be managed by a newly constituted Board of Administration which shall consist of 13 members. Seven members shall constitute a quorum of the Board and the concurring vote of seven members shall be required for the Board to take any action. Prior to April 1, 2005, in anticipation of the effective date, and thereafter, members shall be selected to serve as follows:

- (a) Seven (7) members shall be appointed by the Mayor and confirmed by the Council. No person who is a City employee, participant in the Retirement System, or City union representative may be eligible for appointment in this category. Such appointees shall have the professional qualifications of a college degree in finance, economics, law, business, or other relevant field of study or a relevant professional certification. In addition, such appointees shall have a minimum of fifteen (15) years experience in pension administration, pension actuarial practice, investment management, real estate, banking, or accounting. Members of the Board serving in this category shall serve staggered terms of four (4) years each (inaugural appointments shall have three (3) members serving two year terms) and members in this category shall be limited to a maximum of eight (8) consecutive years in office and an interval of four (4) years must pass before such persons can be reappointed. Such appointees shall not have any other personal interests which would create a conflict of interest with the duties of a Board member and trustee.
- (b) One (1) police safety member of the Retirement System elected by the active police safety members to serve a four (4) year term, except that the inaugural member elected in 2005 to fill the seat in this category shall serve a two (2) year term.
- (c) One (1) fire safety member of the Retirement System elected by the active fire safety members to serve a four (4) year term.
- (d) Two (2) general members of the Retirement System elected by active general members of the Retirement System to serve a four (4) year term.

- (e) One (1) retired member of the Retirement System elected by the retired members of the Retirement System to serve a four (4) year term, except that the inaugural member elected in 2005 to fill the seat in this category shall serve a two (2) year term.
- (f) One (1) City management employee in the administrative service appointed by the City Manager to serve at the pleasure of the City Manager selected from the following: City Manager, City Treasurer, Deputy or Assistant City Manager, or person in a similar position who reports to the City Manager.

The Board of Administration may establish such rules and regulations as it may deem proper; shall elect one of its members president and appoint a secretary and may appoint such other employees as may be necessary. Such appointments, except the actuary, shall be made under the provisions of Article VIII of this Charter.

The Board of Administration shall be the sole authority and judge under such general ordinances as may be adopted by the Council as to the conditions under which persons may be admitted to benefits of any sort under the retirement system; and shall have exclusive control of the administration and investment of such fund or funds as may be established; and shall be permitted to invest in any bonds or securities which are authorized by General Law for savings banks; and, further, shall be permitted to invest in such additional classes or types of investments as are approved by resolution of the Council of the City of San Diego; provided, however, that individual investments within the classes or types approved by the Council must be approved by independent investment counsel; and, provided, further, the board may place such funds in the hands of the Funds Commission for investment. Provided, however, that the Auditor and Comptroller shall refuse to allow any warrant drawn for payment of a retirement allowance if, in the opinion of the Auditor and Comptroller, such retirement allowance has been granted in contravention of this Article or any ordinances passed under the authority granted herein.

Article X: Transfer Of Police And Fire Department Employees Into The Retirement System

Notwithstanding any language in Article IX of this Charter to the contrary the City Council shall, upon the taking effect of this amendment, by ordinance provide for the transfer into The City Employees' Retirement System of all members of the Police and Fire Departments of The City of San Diego who were regularly employed and members of their respective Pension systems on June 30, 1946; provided, however, that in any such ordinance said Council shall provide as follows:

- (1) A minimum retirement allowance of \$200.00 per month when a member has completed the required number of years of service as provided in this Charter, and who at the effective date of the ordinance is receiving a monthly salary of at least \$400.00.
- (2) For retirement of members of the Police Department who entered the service of the department on or prior to the 8th day of May, 1941, and who have served for 20 years or more in the aggregate as a member or employee in any rank or capacity in said department, regardless of age, and for the retirement of members of the Police Department who entered the service of the department subsequent to the 8th day of May, 1941, after completion of 25 years of service in the aggregate.
- (3) For retirement of members of the Fire Department who entered the service of the Department on or prior to January 1, 1936, and who have served for 20 years or more in the aggregate as a member or employee in any rank or capacity in said department, regardless of age, and for the retirement of members of the Fire Department who entered the service of the department subsequent to the 1st day of January, 1936, after completion of 25 years of service in the aggregate.
- (4) Each member of either the Fire or Police Department who is entitled to retire after 20 years of aggregate service with the City shall receive a pension credit of 2 1/2% of his final compensation for each year completed at the effective date of said ordinance, but in no case shall such credit exceed 50% of such final compensation. For each year completed after the effective date of said ordinance the member shall be credited with 1/60th of his final compensation. The pension credits specified above will not be allowable until after such member shall have reached the age of 50 years. No member of either department who is entitled to retire after 20 years as above and who has had 20 years of service in the aggregate shall receive less than the following: \$200.00 per month as retirement allowance, together with such additional amount per month as will represent the actuarial equivalent of that portion of the contributions of such member contributed after his 20th year of service but before his attainment of age 50.

- (5) Members of the Fire and Police Departments who are not eligible for retirement until the completion of 25 years of service in the aggregate shall receive a pension credit of 2% of their final compensation for each year completed at the effective date of said ordinance, provided that such credit shall not exceed 50% of such final compensation, and in addition thereto shall be entitled to credits of 1/60th of their final compensation for each year completed after the effective date of the ordinance. The pension credits specified in this paragraph will not be allowable until after such member shall have reached the age of 55 and has completed 20 years of aggregate service in the department, provided, however, that such member may be permitted to retire at the age of 50 years after 20 years of aggregate service in the department with a reduced allowance, as provided in Article IX and the ordinance passed pursuant thereto.

Except as to those members who are forced to retire because of disability or who die, 'Final Compensation' within the meaning of paragraphs 4 and 5 hereof shall be the highest average compensation received during any five consecutive years of service, limited, however, to the following monthly maximums for members who retire: During the first year after the ordinance is adopted, \$400.00; during the second year, \$500.00; during the third year, \$600.00; during the fourth year, \$700.00; during the fifth year, \$800.00; and after the end of the fifth year there shall be no ceiling considered in determining the amount of the final compensation.

As to those members who are compelled to retire because of disability or who die after the ordinance becomes effective 'Final Compensation' shall be defined as above, but with the following monthly maximums: For death or disability occurring during the first year, after the ordinance is adopted, \$500.00; during the second year, \$600.00; during the third year, \$700.00; during the fourth year, \$800.00; during the fifth year, \$900.00; and after the end of the fifth year no ceiling shall be considered in determining the amount of the final compensation.

- (6) No member of either the Fire or Police Departments transferred pursuant to the provisions of this Article of the Charter shall be required to contribute in excess of 8% of his total salary; and each member so transferred shall be classed as a safety member of a special class and shall be entitled to all of the service credit earned by such member in the Police and Fire Retirement System up to the date of transfer without further contributions from said member because of absences prior thereto while serving in the armed forces of the United States.

- ~~(7) The membership of the Board of Administration created by Article IX of the Charter, upon the taking effect of this amendment, shall be increased to the extent of one additional member to represent the Police Department and one additional member to represent the Fire Department, such members to be chosen by the members of the respective departments.~~

Immediately upon the taking effect of the ordinance making the transfer of members into the City Employees' Retirement System, all of the provisions of Article IX not inconsistent with the hereinabove provided, together with any ordinance passed pursuant thereto, shall be applicable to such transferred members, and the Police and Fire Retirement System heretofore created in 1947 is abolished, and except as prescribed by this amendment all benefits therein authorized are canceled.

All moneys in the Police and Fire Retirement Fund at the date of the taking effect of the ordinance transferring said members are hereby transferred to the City Employees' Retirement Fund.

Nothing herein contained shall be construed in any way so as to affect the vested rights of members of the Police and Fire Departments who have been heretofore retired by virtue of any retirement or pension system of The City of San Diego.

Exhibit 24

FINAL REPORT

CITY OF SAN DIEGO PENSION REFORM COMMITTEE

SEPTEMBER 15, 2004



TABLE OF CONTENTS

	<i>Page</i>
Executive Summary/PowerPoint.....	4
List of Committee Members.....	22
Objectives of Committee.....	23
Introduction.....	23
I. Background.....	24
II. The Current Funded Status of the System.....	25
a. The Pension Plan	
b. Retiree Health Care	
III. How Did This Happen?.....	27
a. Quantification of Causes	
b. Description of Causes	
1. Investment Performance	
2. Under-funding by the City	
3. Use of Plan Earnings for Contingent Benefits	
i. 13 th Check	
ii. Corbett Settlement	
iii. Other	
4. Actuarial Gains and Losses	
5. Benefit Improvements	
IV. Reducing/Eliminating the Unfunded Actuarial Accrued Liability.....	31
a. Pension Obligation Bonds (POBs) as an Option	
b. Using City Real Estate as a Funding Mechanism	
Recommendation #1	
c. Increased Annual Contributions	
Recommendation # 2	
Recommendation # 3	
V. Treatment of Contingent Benefits.....	36
Recommendation # 4	
VI. Treatment of Retiree Health Care Benefits.....	37

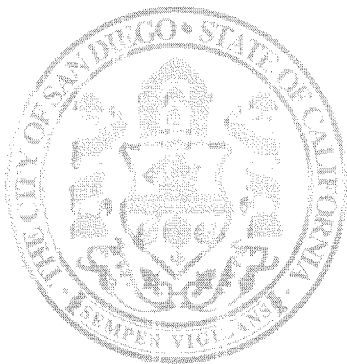
Recommendation # 5

VII. Reduction of Normal Cost.....	37
Recommendation # 6	
Recommendation # 7	
Recommendation # 8	
Recommendation # 9	
Recommendation # 10	
VIII. Retiree Medical Benefits.....	41
Recommendation # 11	
Recommendation # 12	
Recommendation # 13	
IX. Governance.....	43
Recommendation # 14	
Recommendation # 15	
X. Other Recommendations.....	45
a. Study Disability Retirement Application Process and System	
Recommendation # 16	
b. Employee/Employer Sharing of Pension Costs	
Recommendation # 17	
c. Actuarial Assumptions	
XI. Appendices.....	48
a. Biographical Information on Committee Members	
b. Interim Report of Pension Reform Committee to Mayor and City Council	
January 22, 2004	
c. Example: 30 Year Amortization Schedule – Fixed % of Inflation-Adjusted Salary	
d. Retirement Age Factors for Benefits	
e. Study from Gabriel, Roeder, Smith & Company on Proposed New Benefit Structure	
XII. Glossary.....	61
XIII. Bibliography.....	68
XIV. Attachment 1: Additional Information to City Council April 19, 2004....	74

EXECUTIVE SUMMARY

CITY OF SAN DIEGO PENSION REFORM COMMITTEE

SEPTEMBER 15, 2004



Page 4 of 74

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

CITY OF SAN DIEGO PENSION REFORM COMMITTEE



Ms. April Boling, CPA (Chairperson)

President

San Diego County Taxpayers Association

Mr. Stephen Austin, CPA

Managing Partner

Swenson Advisors, LLP

Mr. Robert Butterfield

Attorney

Butterfield Schechter LLP

Mr. Timothy Considine, CPA

Of Counsel

Considine & Considine

Mr. Stanley Elmore

Past President Retired Fire & Police Association

City Retiree

Ms. Judith Italiano

President and General Manager

San Diego Municipal Employees Association

Mr. William Sheffler

Consulting Actuary

Sheffler Consulting Actuaries, Inc.

Mr. Richard Vortmann

President

National Steel and Shipbuilding Company

Ms. Kathleen Walsh-Rotto

Senior Relationship Manager

Principal Financial Group



THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OR GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.



OBJECTIVES OF THE COMMITTEE

- Report back to the City Council no later than 120 days from the date appointments are confirmed.
- After reviewing and considering the scope and depth of audit activity currently being conducted by SDCERS, conduct any additional or supplemental independent audits, studies, or investigations deemed necessary and appropriate.
- Provide recommendations to address any unfunded liability problems of the system.
- Examine how the existing pension system has performed compared to other similar systems, including examination of actions other systems have taken to address funding shortfall problems, such as issuance of pension obligation bonds.
- Examine whether changes should be made to the existing pension system. Examine whether the make-up and representative constitution of the Retirement Board should be restructured.
- Examine whether the system should be changed from a defined benefit plan to a defined contribution plan for new employees.
- Examine whether the City should join the California Public Employees Retirement System or any other retirement system.
- Make any other recommendations as appropriate.



BACKGROUND – PENSION ISSUES

- Current employees and the pension plan sponsor (the City of San Diego) make annual contributions to the pension plan which is a trust. The annual contribution to the City of San Diego's pension plan (Plan) is computed by an actuary. (This annual contribution is typically expressed as a percentage of payroll.)
- When actual experience does not match the assumptions used, the shortfall is spread (amortized) over a period of time and payments are made to ultimately make up the difference.
- When there is a deficit, it means that those assets are not in the Plan's investment pool where they would be generating investment earnings (foregone earnings).
- The City Manager recommends and the City Council approves the Plan benefits. Employees bargain for those benefits through the "Meet and Confer" process.
- The San Diego City Employees' Retirement System (SDCERS) Trustees (the Retirement Board) administer the plan.



THE CURRENT FUNDED STATUS OF THE SYSTEM

- The most recent formal Actuarial Valuation of the Plan is as of June 30, 2003. In that valuation, the Unfunded Accrued Actuarial Liability (UAAL) was calculated at \$1.157 Billion and the Plan was determined to be 67.2% funded.
- At June 30, 2003, the Fair Market Value (FMV) of Plan assets was \$2.329 Billion, while the Actuarial Value was \$2.375 Billion. The difference of \$46 Million will be recognized over future periods. *Note: Adjusted to exclude Port and Airport Assets.*
- The annual valuation does not consider the present value of the Plan's contingent benefits. Contingent benefits are primarily Corbett settlement, 13th check, COLA etc.
- The UAAL was updated to January 31, 2004. Rather than \$1.157 Billion as was identified at June 30, 2003, the UAAL had increased to \$1.167 Billion. The funded ratio, however, had increased slightly to 68.7%.

The Committee calculated the amount of contribution that would need to be transferred into the Plan during FY05 to keep the UAAL from growing as follows:

<u>Contribution Components</u>	(in millions) <u>Contribution Amounts</u>
Normal Cost	\$76.01
Contingent Benefits	20.30
Retiree Medical Benefits (current year premium only)	13.00
Interest (foregone earnings) on the UAAL	<u>93.36</u>
Total	<u>\$202.67*</u>

(*Excludes the unfunded liability for medical costs)

CITY OF SAN DIEGO PENSION REFORM COMMITTEE



In FY04, the City's contribution to the Plan was \$85 Million. The agreed-upon payment for the lawsuit in FY05 is \$130 Million, ramping up to approximately \$180 Million in FY08.

RETIREE HEALTH CARE

THE SECOND DEFICIT IN SDCERS RELATES TO RETIREE HEALTH CARE.

Current retirees' health care is being paid from a special reserve within the Pension Plan.

Currently, this is a "pay as you go" system. Based upon a 5% annual "Medflation" rate, the liability is estimated at \$545 million.

	(in millions)
Normal Cost	\$26.08
Amortization of Liability	<u>\$58.96</u>
TOTAL	\$85.04



HOW DID ALL THIS HAPPEN?

MAJOR REASONS FOR THE UNDER-FUNDED PROBLEM

(From July 1, 1996 to June 30, 2003)

1. Investment performance	6%
2. Under-funding by City	10%
3. Use of Plan earnings for contingent benefits	12%
4. Net Actuarial losses	31%
5. Benefit improvements	<u>41%</u>
	100%

Note: This analysis of under-funding does not include future impact of contingent Corbett Settlement and 13th Check.



DESCRIPTION OF CAUSES FOR UNDER-FUNDED STATUS

1. Investment Performance

The actual investment performance experience in fact has been 8% on average over the long-term.

2. Under-Funding by the City

The City purposely under-funded the Plan through MP I and II. Even if the City had not entered into MP I and II, the deficit would have grown due to the amortization system selected. This was exacerbated by the drain on Plan assets from the payment of contingent benefits and retiree medical benefits.

It appears that this and previous Mayors and City Councils did not understand all the implications of the foregoing and it is possible that many, if not most, of the Retirement Board trustees did not understand.

3 Use of Plan earnings for contingent benefits

The Plan is, in fact, experiencing 8% earnings on its assets. It does not, however, retain those earnings in order to pay future retirement benefits. Instead, a significant portion is siphoned off to pay contingent benefits such as:

**13th Check
Corbett Settlement**



NET ACTUARIAL GAINS AND LOSSES

Major Drivers:

- Extremely low employee turnover
- Significant service purchase subsidies
- Pay increases above those assumed

Retirement/DROP elements

5. Benefits Improvements

A variety of retirement benefits have been granted since 1996. The past service element of these benefits has caused a significant portion of the increase to the Plan's UAAL. The long-term impact of these benefit improvements was not fully understood.

HOW DO WE REDUCE/ELIMINATE THE UAAL?

The UAAL has been treated as off balance sheet debt when in fact it is a full obligation of the City.

When assessing solutions to the Plan's under-funded status, there are two discreet components of the issue:

Recommendations with respect to reduction or elimination of the Unfunded Actuarial Accrued Liability (UAAL) and Recommendations regarding the ongoing annual costs of the basic plan and the contingent benefit.



PENSION OBLIGATION BONDS (POBS)

Recommendation #1

\$600 Million in assets should be infused into the plan over the next three fiscal years. Of that amount, no less than \$200 Million should be placed in the Plan during FY05 (preferably by December 31, 2004) and that amount should be attained through the issuance of Pension Obligation Bonds. Subsequent infusions, bringing the total to \$600 Million can be through POBs, or some form of real estate secured transactions.

The Pension Reform Committee does not support the idea of negative interest amortization and believes that the payment against the UAAL should always be set at a level that actually decreases the debt rather than adding to it.

Recommendation #2

The City Charter should be amended to require that when amortizing net actuarial gains or losses, a period of no longer than 15 years be used for the amortization of losses and that a period of no shorter than 5 years be used for the amortization of a surplus. This change should be effective for FY08 contributions.



Recommendation #3

The City Charter should be amended to require that for all new pension benefit improvements to the currently existing plan, SDCERS will, when setting actuarial assumptions and methodologies, for funding purposes, use an amortization period no greater than straight-line 5 years fixed for any past service liability for each new benefit improvements. This change should be effective immediately.

Because they are not considered in the calculation of a Normal Cost, the net result is that the UAAL grows each year by the amount of the contingent benefits paid and the amount of the addition to the Plan's retiree "health care reserve". The Pension Reform Committee believes that an amount equal to the value of the contingent benefits siphoned from the Plan earnings should be replaced by the City annually based on an estimate calculated at the beginning of the fiscal year for that fiscal year.

Recommendation #4

The City's annual required contribution to the Plan for a given year should be defined as the total of Normal Cost, UAAL amortization (including interest), and an amount equivalent to the estimated contingent liabilities related to that year.



TREATMENT OF RETIREE HEALTH CARE BENEFITS

Recommendation #5

Payments for retiree health care benefits should no longer be funded via the retirement plan. SDMC 24.1502(a)(5) should be eliminated thereby removing health care benefits from the Plan's distribution waterfall.

REDUCTION OF NORMAL COST

The City's pension benefits are generous by almost any standard applied (24% of payroll.)

Recommended changes 6-10 will impact new hires only. The savings illustrated will only be fully realized only when all employees under the existing benefit structure have retired.

Recommendation #6

The normal retirement age should be raised by seven years for all employees and the early retirement age should be set at a number of years that are five years less than the normal retirement age. Any retirement earlier than normal age will be cost-neutral, actuarially reduced.

CITY OF SAN DIEGO PENSION REFORM COMMITTEE



This will result in a savings of 3.69% of pay, or based on current payroll, \$22,342,000.

The above recommendation will result in the following normal and early retirement ages:

	<u>Normal</u>	<u>Early</u>
General members	62	57
Fire and Police	57	52
Legislative	62	57

REDUCTION OF NORMAL COST

Recommendation #7

The annual accrual rate for the percentage of the final base payroll to be used in calculating the pension benefit is reduced by 20%.

This will result in a savings of 2.61% of pay, or based on current payroll, \$15,774,000.

The above recommendation will result in the following accrual rate percentages:

General Members	2.0%
Fire and Police	2.4%
Legislative	2.8%

Recommendation #8

The final base payroll should be based on an average of the employee's highest three years of salary rather than on the highest one year of salary.

This will result in a savings of 1.06% of pay, or based on current payroll, \$6,413,000 annually.



Recommendation #9

The final base payroll should exclude salary differentials such as second shift differential, bilingual differentials, etc.

This will result, conservatively, in a savings of 3.5% of pay, or based on current payroll, \$21,175,000 annually.

Note: The cumulative effect of Recommendations 6-9 is substantial, but not additive.

RETIREE MEDICAL BENEFITS

Recommendation #10

Eliminate specific programs that permit DROP and purchase of years of service credits, except those that are federally protected.

Recommendation #11

The City should establish either a separate trust or a separate accounting within the pension trust to account for the assets and liabilities of the retiree medical benefit plan. Retiree Medical Plan assets may be commingled with Retirement Plan assets for investment purposes, but be accounted for separately for all other purposes. Annual contributions to the Retiree Medical Plan should be separately identified in the City budget and in no way be confused or commingled with Retirement Plan contributions.

CITY OF SAN DIEGO PENSION REFORM COMMITTEE



The Governmental Accounting Standards Board (GASB) has acknowledged this problem.

The newly-issued Statement 43 provides a framework for transparent financial reporting by governmental entities that have fiduciary responsibility for OPEB plan assets regarding their stewardship of plan assets, the funded status and funding progress of the plan, and employer contributions to the plan.

RETIREE MEDICAL BENEFITS

Recommendation #12

Adopt GASB Statement #43 (Financial Reporting for Participant Benefit Plans other than Pension Plans), effective July 1, 2005

The above recommendations deal with the accounting for the benefits, they do not address the ability or inability of the City to fund this already-existing liability.

Recommendation #13

When amortizing the unfunded liability for retiree medical benefits, a method should be used that does not create negative amortization of the liability.

The City Charter currently dictates the composition of the 13 member Board of Trustees as follows:

- 3 representatives from City management
- 2 representatives elected by police and fire members
- 3 representatives elected by General Members
- 1 representative elected by retired members
- 4 independent citizens nominated by the Mayor and appointed by Council

CITY OF SAN DIEGO PENSION REFORM COMMITTEE

Page 19 of 74

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.



At the heart of the concern is that, of the 13 members of the Retirement Board, 8 members (62%) can clearly benefit by enabling the City to fund its current operating budget at the expense of the retirement plans.

The second significant problem is the technical skill required to understand the complex issues may not be sufficient.

GOVERNANCE

Recommendation #14

Change the composition of the Retirement Board to seven members appointed by the City Council. These members will serve with staggered terms of four years each, with a two consecutive term maximum. Such appointees will have the professional qualifications of a college degree and/or relevant professional certifications, fifteen years experience in pension administration, pension actuarial practices, investment management (including real estate), banking, or certified public accounting. Such appointees will be US Citizens and resident of the City of San Diego, but cannot be City employees, participants (directly or indirectly through a direct family member) of the SDCERS, nor a union representative of employees or participants, nor can such appointees have any other personal interests which would be, or create the appearance of, a conflict of interest with the duties of a Trustee.

Recommendation #15

An additional provision should be made to the City Charter that would codify the current disability retirement determination process as it is now except that the hearing officer's decision would be final rather than a recommendation for the Board for approval.

Study disability retirement application process and systems.



OTHER RECOMMENDATIONS

Recommendation #16

The City should establish a committee to review the entire disability retirement system. Representatives on this committee should include knowledgeable employees of both the City and SDCERS as well as outside professionals with experience in this area (Employee/Employer Sharing of Pension costs.)

Recommendation #17

The City Council Rules Committee should require a report (with recommendations) From SDCERS on the issue of the 50/50 employer/employee cost split by the end of the calendar year (Actuarial Assumptions).

Exhibit 25



THE CITY OF SAN DIEGO

November 18, 2002

Honorable Dick Murphy and Members of the City Council
City of San Diego
City Hall - 202 C Street
San Diego, CA 92101

Re: Items 50 & 51; re Retirement Benefits

Dear Mayor Murphy and Members of the City Council:

**CITY ASKED TO ENTER INTO IMPRUDENT FINANCING PROGRAM WHICH FAILS TO
CORRECT ACCOUNTING IRREGULARITIES AND THREATENS SAFETY OF CITY
EMPLOYEES RETIREMENT AND BENEFIT SYSTEM IN CONFLICT WITH ACTUARY'S
ADVICE**

Action items 50 and 51 represent a potential insolvency formula for the City of San Diego in less than 9 years.

This deal has surfaced because, under the existing 1996 City Manager's Agreement, if the Retirement Plan's funding ratio (the amount funded vs. the funding requirement designated by the independent Actuary) falls below 82.3%, (which our Actuary has suggested will happen this year), the City is required to make a much larger contribution (\$25 - 75 million this year and even larger in future years) to restore the plan's funding status. It appears that the City does not want to make these required payments. This new agreement before you today was reached to allow the City not to have to make the required payments and in return an additional employee benefit was granted. The new agreement "back loads" the entire accrued burden to the City Council of 2009.

Because the City could not compel the Retirement Board to accept this dangerous agreement, the City "conditioned" the Labor deal on Retirement Board approval of the City's diminished pension contribution agreement and balloon payment obligation agreement, and then had City representatives and Labor representatives vote it through the Retirement Board this past Friday (the motion passed with two dissenting votes, myself and that of Tom Rhodes). This conditioning of benefit enhancements on Retirement Board approval created conflicting concerns on the part of City and Labor representatives that sit as Trustees on the Retirement Board. The City Trustees faced concerns of job preservation and personal economic benefit, and the Labor Trustees faced the obviously enhanced pension benefits to their members. The City should not have put the City and Labor members of the Retirement Board in this awkward position. Tying a labor contract benefit to a separate fiduciary decision co-ops the Board's normal role as overseer of the "administration" of benefits. In a sense, it gives the appearance, if not the reality, that the City "bought" votes on the Retirement Board.

I commented at this past weeks Retirement Board meeting, that promising a city employee benefit conditioned upon a separate fiduciary's approval of an agreement to reduce the already deficient City contributions to its pension plan is ethically questionable at best, if not blatantly corrupt.

BACKGROUND

City Council Items 50 and 51 on the Agenda for November 18, 2002 require your approval of Ordinances that amend the San Diego Municipal Code in relation to the FY 2003 Negotiated Retirement Benefit Enhancements. The affect of the proposed Ordinances would, among other things:

City Employees' Retirement System
401 S Street, Suite 400, MS 240 • San Diego, CA 92101-4298
Tel: (619) 533-4660 Fax: (619) 533-4611 • 533-4629

247.6

0247-0006



1. Lower the City's existing contribution rate (specifically if the plan falls below 82.3% funded) which has already been found by the independent Actuary to be currently inadequate to provide for the contracted retirement obligations for City employees,
2. Provide increased benefits without providing any current funding to fund those benefits,
3. Create a balloon obligation for the City to partially fund the accrued but unpaid obligations identified in 1 and 2 above, which will begin the year after the expiration of the term limits of the existing Council and Mayor,
4. Allow for an unspecified "transition period" to change the Retirement System's irregular and misleading "Projected Unit Credit (PUC) rate" accounting practices (these are our existing non-conforming accounting practices) to the more conventional and accurate "Entry Age Normal (EAN) rate" (the accounting methods used by the vast majority of other California public retirement systems, see attached list of Public Pensions Systems in California using EAN.)

These Ordinances came about as a result of the "meet-and-confer" process between the City and its Labor Unions. The Retirement Board, as a body, is not a party to those negotiations, although representatives of labor and City Management are involved. The Retirement Board was subsequently asked to approve this new reduced pension contribution agreement and balloon payment obligation agreement after the deal had been made by the City and the Unions. Because the City could not compel the Retirement Board to accept this dangerous agreement, the City "conditioned" the Labor deal on Retirement Board approval of the diminished pension contribution agreement and balloon payment obligation agreement, and then had City representatives and Labor representatives vote it through the Retirement Board this past Friday (the motion passed with two dissenting votes from Trustee Tom Rhodes and myself).

In addition, the proposed Ordinances provide an unspecified "transition period" to change over from what is known to be irregular and misleading accounting practices used by the City's Retirement System rather than require immediate accounting compliance with the more accurate and intelligible methods and procedures used everywhere else.

The proposed Ordinances and the decision to approve them are fiscally reckless and irresponsible. It does not ensure the financial integrity and the security of the Retirement System. These proposed ordinances, if approved, additionally weaken the already financially impaired retirement system because:

1. The Retirement System is currently under-funded as a result of the 1996 City Manager's proposal. According to the System's Fiduciary Council, from July 1, 1996 through June 30, 2002, the deficiency between what the City contributed and what would have been contributed under the amounts computed in accordance with the actuarial valuation, plus earnings on the difference totals about \$100 million. According to the System's independent Actuary, as of the June 30, 2001 Annual Actuarial Valuation the unfunded actuarial accrued liability was \$283,892,737. If these ordinances are approved, by 2009, the City will most likely be faced with the "sticker shock" of an unfunded pension liability in the multiple billions of dollars.
2. According to the Retirement System's independent Actuary, on an "EAN" measurement basis, *the San Diego City Employees' Retirement System already has one of the lowest funding ratios in the State of California.* (Measurement by the more generous "PUC" method showed that in 1996 the pension plan was 91% funded, by the end of this year it will most likely drop below 80%).
3. According to the Retirement System's independent Actuary, the San Diego City Employee's Retirement Systems' *funding ratio is already the lowest it has been since the 1980's.*
4. City contributions have *not* increased over the scheduled amounts in the 1996 Manager's Proposal even though the City granted benefit increases under the Retirement System since the adoption of that Proposal, most notably, the benefits provided under the "Corbett" settlement.

247.7

0247-0007



5. The Retirement System has lost hundreds of millions dollars in it's investment portfolio.
6. The System's investment consultant forecasts the likelihood of lower and more volatile earnings in the future than in the past 10 years.
7. The substantial reduction in interest rates due to action by the Federal Reserve Bank has materially decreased the current interest received and potential future interest generated by the fixed income portion of the System's investment portfolio.
8. Many Retirement System liabilities are not even included in the System's existing irregular (PUC rate) accounting system for calculating the funding ratio. For example, there are hundreds of millions of dollars of obligations the System does not reflect on its books, such as the "Corbett" settlement obligation for retirees - worth about \$76 million dollars, two Reserve Account obligations, the reserve for Supplemental COLA, the 13th Check obligation, or the Retiree Health Insurance and Post Retiree Health Care obligation. Additionally, there is no consideration of the fact that employees are retiring at an earlier age, which has a major impact on future Retirement System obligations and has been strongly recommended be included by the Actuary for several years. All of the above liabilities have been noted by the System's independent Actuary as being significant economic reporting omissions and if considered would materially lower the current funding capacity.
9. After meeting it's other obligations, it is expected that the Retirement System will effectively have no "surplus earnings" at the year ending June 30, 2002, to fund new benefits or to make up funding shortfalls.

The Retirement System's independent Actuary has consistently opposed the items reflected in these two proposed ordinances in the most explicit of terms and has specifically written in a letter dated November 5, 2002 to the Retirement Board, "it would be best to hold the City to the existing Manager's proposal..." Additionally, the Actuary has recommended against the "transition period" for correcting the inadequate accounting practices, which have created an artificially healthier appearance of the System's financial condition. Specifically he writes, "we would prefer it if the Board did not provide a transition period to the City to reach the full PUC rate and then move to the full EAN rate." (See attached letter from Actuary). The Actuary may be replaced as a result of his honesty and professionalism.

One of the legal cases provided to us by our fiduciary counsel is enlightening. The most recent decision in California with respect to funding requirements states, *"The willingness and ability of the sponsor of a defined benefit pension plan to maintain this 'orderly schedule' (of contributions well in advance of benefit requirements) is the major factor in the assurance of benefit security for retirees..."* 52 Cal.App.4th 1139, quoting from the declaration of the PERS Actuary. Additionally, that decision said, in part, *"Underpinning both the normal cost calculation and the amortization of the unfunded accrued actuarial liability is an explicit assumption concerning timing of contributions. The importance of timing stems from the fact that a large portion of a member's benefit is funded by the investment earnings, which are generated by the plan contributions. When monies are contributed later than expected, reduced earnings result - thus creating a shortfall."* at 1140 quoting from the PERS Actuary. *Board of Administration v. Wilson*, 52 Cal.App.4th (1997).

The Government Finance Officers Association has said that public officials should do the following: *"Assure that actuarially required contributions are collected by the pension plan on a timely basis. Reductions in or postponement of contributions violates one of the basic principles of level percent-of-payroll financing and constitutes a real threat to responsible funding."* (GFOA STATEMENT OF RECOMMENDED PRACTICES FOR PUBLIC PENSION PLANS, Recommendation 3 concerning funding.)

CONCLUSION

I strongly recommend that you, as representatives of the public trust, do not vote to approve these Ordinances. However, if you are intent upon doing so, I would suggest that you send this issue to your

247.8

0247-0008



Ethics Commission before voting on it. I would also strongly recommend that you have outside Legal Council provide you with an opinion on this issue. In discussions with the Retirement Systems' Fiduciary Council it was suggested that approval actions may not be covered by governmental immunity and that there may be a personal exposure resulting from an affirmative vote on this matter.

Respectfully,

Diann Shipione

Diann Shipione

Trustee, San Diego City Employees' Retirement System

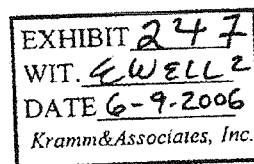
cc: Trustees of the San Diego City Employees' Retirement System
Rick Roeder, Actuary, Gabriel, Roeder, Smith & Company
Bob Blum, Esq. Fiduciary Counsel
Mr. Charles Walker

247.9

0247-0009



CITY OF SAN DIEGO
M E M O R A N D U M



DATE: December 6, 2002

TO: Honorable Mayor and City Council

FROM: P. Lamont Ewell, Assistant City Manager

SUBJECT: San Diego City Employees' Retirement System (SDCERS) Benefit Enhancements; Response to Public Comment and Correspondence on Items 50 and 51 Adoptions Agenda, Consent Items

BACKGROUND

The November 18, 2002 City Council docket included two Ordinances (adoption of Item 50 and introduction of Item 51) amending the Municipal Code to implement the retirement benefit enhancements approved by the Council during the recently concluded meet and confer process.

Item 133 on the November 18, 2002 docket requested approval of two Resolutions. The first Resolution requested approval of an agreement between the City of San Diego and the San Diego City Employees Retirement System Board of Administration regarding employer contributions. This agreement was drafted jointly by the SDCERS independent fiduciary counsel and City Attorney's Office, and was approved by a 10-2 vote of the SDCERS Board on November 16, 2002. The second Resolution was an agreement to indemnify the SDCERS Board Members in the performance of their duties, standard for City Boards and Commissions pursuant to the City Charter.

The morning of November 18, 2002, Ms. Diann Shipione delivered a letter (Attachment 1) to the Mayor and City Council urging a "No" vote on Items 50 and 51. She also spoke at the City Council meeting in opposition to these items.

All three items were approved by the City Council by an 8 to 1 vote.

247.1

00005

0247-0001



DISCUSSION

Ms. Shipione is a citizen-Member of the SDCERS Board. Although Ms. Shipione's letter was on SDCERS letterhead, the SDCERS President and the Administrator have confirmed that the comments and opinions contained in her November 18 correspondence and her remarks during the Council meeting were not representative of the Board, but rather, were her opinions as an individual Member.

It is important to distinguish between the *benefit improvements* included in Items 50 and 51, and the *Employer Contribution Agreement* with SDCERS approved in Item 133. The SDCERS Board has no role in determining the retirement benefits for City employees. The City negotiated and agreed to benefit improvements with its labor organizations. Items 50 and 51 implement those benefits already approved in MOU's with labor organizations. Those benefit improvements have a cost associated with them. The SDCERS Board is charged with the responsibility for determining the contribution rates to be paid by the City. The SDCERS Board hires an independent actuary to perform an annual valuation of the system, and to recommend contribution rates for adoption by the Board. The Board in turn advises the City as to the contribution rates it should pay to maintain the financial integrity of the system. The Board's actuary calculated the costs associated with the benefit enhancements, and the City will be paying that additional cost beginning July 1, 2003. Ms. Shipione's comments seem to be more related to Item 133, the Agreement between the City and the SDCERS Board regarding the City's contribution rate.

The following response to Ms. Shipione's remarks demonstrate that she has omitted, slanted and misrepresented the facts related to these matters to support her personal discomfort with the actions approved by the SDCERS Board. These responses address four major areas of concern raised by Ms. Shipione.

Issue 1: "City asked to enter into imprudent financing program."

The "financing program" referred to in simple terms is an agreement between the City and SDCERS Board whereby the City will gradually increase its contribution rate each year until reaching the full actuarial rate. This transition period requires the City to reach the full actuarial rate no later than 2009. The Agreement also includes a safeguard such that if the funding ratio of the retirement system falls below a specified rate (82.3% of a fully funded system), the City will begin a 5-year phase in of the full actuarial contribution rate. This Agreement replaces a 1997 Agreement that would have resulted in an immediate jump to the full actuarial rate if the system's funding ration dropped below the 82.3% level. Such a immediate jump would have resulted in approximately a \$25 million increase in next year's contributions to retirement. The

247.2

0247-0002



new Agreement was discussed at SDCERS Board meetings on May 29, June 21, and July 11, 2002. The SDCERS Board's independent fiduciary counsel (Mr. Bob Blum) and independent actuary (Mr. Rick Roeder) evaluated, analyzed and provided advice to the Board prior to their approval of the Manager's proposal. On July 11, the Board approved the proposal in concept with instruction to the fiduciary counsel to: (1) prepare a written formal agreement codifying the terms, and (2) provide a formal written opinion as to whether this agreement "would be a reasonable exercise of the Retirement Board's fiduciary responsibilities."

At the conclusion of Mr. Blum's legal analysis, he concluded that: "In these circumstances, it is reasonable for the Board to have decided that this Agreement is the best way to achieve long term financial integrity and soundness of SDCERS. The Board has diligently examined the alternatives presented by the City and requested input from its outside experts. The Board provided a full and reasoned consideration of the facts and issue before approving the Agreement. Therefore, it is our opinion that it is reasonable for the Board to enter into the Agreement in the exercise of its fiduciary responsibilities."

Issue 2: Ms. Shipione asserts that "promising a city employee benefit conditioned upon a separate fiduciary's approval of an agreement to reduce already deficient City contributions to its pension plan is ethically questionable at best, if not blatantly corrupt."

Contrary to implications in Ms. Shipione's letter, the City has gradually increased its contributions to the retirement system over the past six years. However, the rapid turn in the economy the past two years, especially following the September 11 tragedy, resulted in substantial investment losses of SDCERS assets (approximately a \$400 million loss). The City Manager's office was concerned about the impact of these events on SDCERS funding ratio, and the potential \$25 million cost impact to the City should the funding ratio drop below the 82.3% trigger as a result of these losses. The City is required by the Charter to complete its labor negotiations by mid May. Included in the negotiations were several improvements in retirement benefits which would result in additional contribution costs to the City. The City expressed its willingness to approve the increased benefits, primarily to stay competitive with other public sector plans in California, but was concerned about the potential \$25 million impact of the trigger. Consequently, the City's offer to improve retirement benefits was made contingent upon the City, separate from these labor negotiations, reaching an agreement with the SDCERS Board that would prevent this \$25 million sudden impact on next year's budget. Discussions with the SDCERS Board began after and separate from labor negotiations. The fact the eight employees who are members and beneficiaries of the retirement system sit as Trustees of the SDCERS Board has been raised periodically as a potential conflict. Each time, fiduciary counsel and the City Attorney's Office remind the Board that the City Charter expressly designates eight

247.3

0247-0003



employee seats on the Board (three ex-officio management members and five employees elected by their peer employees), and that such appearance of conflict is not a problem without an actual breach of trust. The Members of the Board were strongly admonished by their fiduciary counsel during each discussion of this Agreement as to their fiduciary duty to the system. Outside counsel in the past has opined that "If a trustee, in making decisions as a trustee, acts solely and exclusively in the interest of and for the purpose of providing benefits to participants and their beneficiaries, minimizing employer contributions there, and defraying reasonable expenses of administering the system, the trustee does not violate his or her fiduciary duties to the system."

Issue 3: The Agreement "fails to correct accounting irregularities."

Ms. Shipione claims that the Agreement "provides an unspecified transition period to change over from what is known to be irregular and misleading accounting practices used by the City's Retirement System rather than require immediate accounting compliance with the more accurate and intelligible methods and procedures used everywhere else."

In fact, the Agreement provides a specific transition period, which is the same period established in the original 1996/97 Manager's Proposal. The Board's actuary, in the letter provided to the Board states that "The Board must exercise its judgment in deciding whether a transition period is needed . . ." and that "if the Board decides that a transition period is needed, then the transition period chosen is reasonable as the City will commit to contribute an additional amount each year starting in July 2004 . . ." The new Agreement further establishes an even shorter transition period of five years should the 82.3% funding ratio be triggered. None of the SDCERS experts (fiduciary counsel, actuary, the City's independent auditor, nor City Auditor) have ever suggested any accounting irregularities. In response to questions from the SDCERS Board, their actuary advised that while most independent public retirement systems in California use what is referred to as "entry age normal" funding method, in fact seven major independent California public retirement systems use the same funding method, "projected unit credit," that SDCERS currently uses. The projected unit credit method is one of several acceptable actuarial funding methodologies. The Agreement entered into between the City and includes a provision to convert to the entry age normal method. Either method is a perfectly acceptable actuarial funding methodology.

Issue 4: The Agreement "Threatens the safety of the retirement system."

Ms. Shipione comments that the most recent actuarial valuation indicates SDCERS has an unfunded actuarial accrued liability of \$283,892,737. Ms. Shipione also points out that "the retirement system has lost hundreds of millions (of) dollars in its investment portfolio." Every

247.4

0247-0004

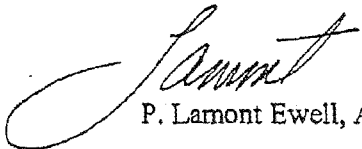


appropriately take a long term approach in establishing funding systems for the payment of benefit obligations. Ms. Shipione appears to prefer that the City make up this recent investment loss by an immediate substantial spike in contributions. After requesting advice from their experts and after many hours of deliberation, in the exercise of their due diligence, the SDCERS Board approved the Agreement on employer contributions. The fiduciary opined as follows: "The Board exercised its judgment and decided that, weighing all factors—including risks, probabilities of events, need for stability and assurance as to contribution levels, and especially the importance of moving on a sure and steady path to full contribution rates—the Agreement is a positive action to create financial integrity and soundness for SDCERS."

CONCLUSION

The City negotiated retirement benefits in the meet and confer process with a contingency related to certain financial impacts, specifically the Agreement with the SDCERS Board related to employer contributions are costs therefor. The SDCERS Board, exercising its fiduciary responsibilities, approved the contribution/funding plan and entered into an Agreement with the City, based upon the advice of the Board's fiduciary counsel and independent actuary. The Council approved the Agreement on November 18, 2002. There was nothing in the process that was either improper, irregular, or unlawful, and Ms. Shipione's comments are without merit.

Respectfully submitted,



P. Lamont Ewell, Assistant City Manager

LEXIN/DEK

Attachment: Ms. Diann Shipione's November 18, 2002, Four Page Letter to Honorable Mayor and City Council

247.5

0247-0005



Exhibit 26

Citizen's arrest of Shipione weighed

Contingency not used in pension board fight

By Philip J. LaVelle
UNION-TRIBUNE STAFF WRITER

December 16, 2004

San Diego city pension officials planned to make a citizen's arrest of outspoken board member Diann Shipione last month and have police remove her from a private meeting.

The plan was not put into action because Shipione had left the building before the pension board entered closed session Nov. 19. At the closed meeting, the board voted on several punitive actions against Shipione, including seeking her permanent removal as a pension trustee.

These new revelations underscore the bitter divisions between San Diego's pension system establishment and Shipione, whose warnings about underfunding and other irregularities have sparked federal investigations, Wall Street scrutiny and national media attention.

Pension officials involved in the plan said they thought it was prudent. "We felt the provision was necessary because we felt there was a possibility that Ms. Shipione might not accept the decision of the board," pension administrator Larry Grissom said in an interview.

In its closed session, the board voted to file a complaint against Shipione with the city's Ethics Commission, accusing her of improperly disclosing confidential information about attorney fees.

She says she only told a retiree, in vague terms, about fee arrangements, and did nothing wrong.

The board also voted to ban her from future closed sessions and ask Mayor Dick Murphy, who has borne the brunt of two years of negative news generated by the pension mess, to kick her off the board.

Shipione says the board violated the state's open-meeting law, and that Murphy lacks the authority to boot her.

"The board is obviously planning to do something really irregular very soon, which is why they have to get me off the board," Shipione said yesterday.

The move to involve police called for two patrol officers to be posted downtown, near the retirement system's offices in the Wells Fargo building on B Street, and for retirement board President Frederick W. Pierce IV to ask for their assistance after making a citizen's arrest of Shipione if she did not leave on her own.

Grissom confirmed that the plan was ready to go on the day of the meeting. Grissom said it was his idea and was discussed in advance with Pierce and board member Charles Hogquist, a San Diego Police Department lieutenant.

Hogquist described the planning in detail, saying it was done to preclude the need for a call to 911 and was intended "to spare anybody embarrassment."

He said the officers would have had discretion on what to do after taking custody: They could have merely escorted Shipione out and released her; they could have issued a citation; or they could have arrested her and booked her into jail.

In an interview yesterday, Pierce said at first that he was "not at all aware of what the logistics would have been."

Told that Hogquist said he reminded Pierce he would have to make a citizen's arrest for police to come, Pierce said, "Yeah, the truth is, in recalling back, I was aware at some point – and it probably was that day – and I don't remember when that day."

Pierce defended the plan as proper.

"I think that any time one might expect a disturbance, one does contingency planning," he said.

Through his press secretary, Murphy was asked yesterday what he thought of involving police in the Shipione affair. "I have no personal knowledge of what transpired between the retirement board and Diann Shipione," Murphy said in a statement released by his office.

Shipione said she was not aware she would be discussed at the closed session and was informed of the board's votes in a Nov. 22 letter from pension system lawyer Lori Chapin.

Among the actions the board is hoping to take with her gone, Shipione said, is a multimillion-dollar settlement in a malpractice case against the board's former fiduciary counsel that she says could amount to insurance fraud.

In recent years, Shipione has been an irritant both to fellow board members and to City Hall in general, warning of the dangers of underfunding the pension system while boosting benefits, a practice that has played a key role in the system's \$1.2 billion deficit.

She also has brought to light financial irregularities, forcing city officials this year to admit to errors and omissions in financial statements used by bond investors.

As a result of these revelations, the city has suffered several credit-rating downgrades – one major agency suspended the city's credit in September because of a missing audit – and sparked investigations by the Securities and Exchange Commission, the FBI and the U.S. attorney.

This has left the city unable to issue bonds for important projects such as sewer upgrades.

Increasingly, politicians and the public have been expressing concern over the city's financial problems – and now the pension board's actions against Shipione.

Earlier in the week, Pierce denied that moves were taken against Shipione in a bid to silence a prominent whistleblower.

Grissom said he came up with the plan to involve police officers "out of an abundance of caution."

Hogquist said he was contacted by Grissom two days before the Nov. 19 meeting and was told a board member might have to be excluded from closed session. "I was asked if the police would be available to escort them out if there was a disturbance," he said.

Hogquist, a detective lieutenant in the department's Western Division, said he explained to Grissom that police can't simply escort someone from a meeting. He said police can act, however, if a citizen's arrest is made for a suspected criminal violation such as trespassing or disturbing the peace.

"I contacted a lieutenant and asked if he could have a couple of officers in the area, not in the building. They were just supposed to be somewhere in the area, a couple of blocks away, doing routine stuff," he said.

Hogquist said he did not directly contact the patrol officers because he did not want his rank to influence their judgment in the board room.

"I did not discuss it with Pierce," Hogquist said of the planning with Grissom. "But I did remind Fred on the day of the meeting, on Friday, that if Diann refused to leave, he as president would have to make the citizen's arrest, or otherwise the police would not come."

Asked if he felt torn about such possible action, Hogquist said: "Of course. I understand and respect Diann's right for free speech. But at the same time, when people came to me and said there might be a possible violation of the law, I have to act as a police officer."

He added that police have been called to board meetings after irate retirees have threatened trustees' lives. "Those are easy (calls), but this is a tough one," he said.

Shipione said she plans to attend tomorrow's closed session.

"I'm a trustee, and as a trustee, I have a responsibility to attend all meetings, both open and closed, as long as they're legal," she said. "If the board is going to prohibit me and actually does call the police, I imagine that I will allow them to escort me out and deal with it from there."

Pierce said: "We do not intend to allow her to participate."

He said, however, that he will not attempt a citizen's arrest.

Asked what will happen if Shipione refuses to leave, Pierce said, "Well, I guess we'll cross that bridge when I come to it."

Hogquist said, "To be honest with you, the Police Department won't be involved."

Added Grissom: "No, we will not enact this plan, because I don't think this particular plan, obviously, will work."

Find this article at:

<http://www.signonsandiego.com/news/metro/20041216-9999-1n16pension.html>

☐ Check the box to include the list of links referenced in the article.

Exhibit 27

INTERIM REPORT NO. 9

**REPORT ON BREACH OF CONTRACT,
FIDUCIARY DUTIES, AND PROFESSIONAL
NEGLIGENCE BY VINSON & ELKINS LLP**

**REPORT OF THE
SAN DIEGO CITY ATTORNEY
MICHAEL J. AGUIRRE**

**OFFICE OF
THE CITY ATTORNEY
CITY OF SAN DIEGO**

**1200 THIRD AVENUE, SUITE 1620
SAN DIEGO, CALIFORNIA 92101-4178
TELEPHONE: (619) 236-6220**

26 JULY 2006

I.

INTRODUCTION

The San Diego City Attorney is issuing Interim Report #9 related to alleged unlawful acts and improper activities associated with the City of San Diego's pension crisis. In previous Interim Reports, the San Diego City Attorney addressed the substance of the alleged illegal acts and improper activities by City officials and outside consultants. In this, Interim Report #9, the City Attorney discusses the role of Vinson & Elkins LLP.

On 18 February 2004 the City of San Diego entered an agreement with Houston-based law firm Vinson & Elkins to investigate possible illegal activities by San Diego City officials involving the City's pension plan.

The firm's primary responsibility was to conduct an investigation intended to satisfy KPMG, the City's outside auditor, that an appropriate "illegal acts" investigation had been conducted by the City in conformance with applicable auditing standards. As detailed below, Vinson & Elkins failed to complete this task.

The firm was hired again by the City in October 2004 to conduct another investigation in conformance with the applicable auditing standards to reassure KPMG that "illegal acts" had not taken place. As this report will illustrate, Vinson & Elkins failed to complete task.

The City Attorney now concludes that Vinson & Elkins breached legal duties it owed to the City of San Diego. Vinson & Elkins' breach of legal duties to the City has been the proximate cause of substantial damages suffered by the City.

II.

CITY OF SAN DIEGO HIRES VINSON & ELKINS

The City of San Diego is facing a series of daunting political and financial crises that threaten its solvency. The myriad of problems are dominated by a pension deficit estimated between \$1.4 billion and \$2 billion resulting from a number of financial factors including, but not limited to, the creation of retirement benefits that the City Attorney contends are illegal.

These benefits are the result of two contingent, *quid pro quo* arrangements between the San Diego City Council and the San Diego City Employees' Retirement System (SDCERS). The potential magnitude of the pension debt – also called the unfunded liability – was discovered in late 2001. At that time, information about the growing nature of the shortfall was communicated to SDCERS and some City officials but hidden from the public.¹

¹ 3 December 2001 e-mail from Assistant City Auditor and SDCERS Board Trustee Teresa Aja Webster to SDCERS Administrator Lawrence Grissom and carbon-copied to City Human Resources Director and SCERS Board Trustee Cathy Lexin. RE: "earnings EEEK!" (Exhibit 1)

In January 2003, the Houston-based law firm of Vinson & Elkins LLP (“V&E”) was one of three firms that responded to a request for proposal to review the City’s newly created investor-information Web page to ensure conformance with securities regulations and industry guidelines. The Web page was designed to provide publicly accessible investor information, including the continuing disclosure of annual reports and related information. Based on the firm’s specialized experience and their bid to perform the services for the fixed fee of \$30,000, the City’s contract was awarded to Vinson & Elkins.²

In December 2003, the firm’s contract was amended to include additional consultation and legal services relating to the City’s Web site and “other disclosure-related issues as-needed for a period of two years” at a cost of no more than \$27,000.³

During this period – before the firm was hired to perform its illegal acts investigation – Vinson & Elkins interviewed key City employees who possessed in-depth knowledge of the pension system and the funding shortfall, and strategized with these individuals, some of whom would later be indicted, about what corrective efforts were or were not appropriate.⁴ As will be explained in this report, months before the City hired Vinson & Elkins to conduct the illegal acts investigation, the firm had already formed important opinions about the appropriateness of the City’s response to the discoveries⁵ and who had caused the problems in the first place.⁶

The City filed voluntary corrections to its Certified Annual Financial Report for the year ending 30 June 2003 (“CAFR”) in January 2004 and in March 2004, calling attention to debts, factual and other errors that were omitted from previously released financial disclosures.⁷ The City has not issued a CAFR, or audit, since fiscal year 2002. The lack of audited financials, among other issues, has prevented the City from borrowing money in the public markets.

² Request for City Manager Action, Agreement for Electronic Disclosure Counsel Services dated January 24, 2003; and Auditor’s Certificate number 2300865. (Exhibit 2)

³ Request for City Manager Action; First Amendment to Agreement for Electronic Disclosure Counsel Services dated December 9, 2003; and Auditor’s Certificate number 2400703. (Exhibit 3)

⁴ 26 November 2003 handwritten notes from former-Assistant City Auditor Teresa Aja Webster. (Exhibit 4)

⁵ 26 November 2003 handwritten notes from former-Assistant City Auditor Teresa Aja Webster. (Exhibit 4)

⁶ 26 November 2003 handwritten notes from former-Assistant City Auditor Teresa Aja Webster. (Exhibit 4)

⁷ Municipal Secondary Market Disclosure. (Exhibit 5)

The filing of the voluntary disclosures raised concerns with the U.S. Securities and Exchange Commission (SEC) and the U.S. Attorney's Office. Both agencies launched investigations of the City.

In February 2004, the City Manager authorized the City to retain Vinson & Elkins to both provide assistance in performing a review of then-current and past financial disclosure practices, and to respond to the SEC inquiry. The City appropriated \$150,000 for this purpose.⁸ The letter of engagement authored by Vinson & Elkins promised to:

- Perform an investigation with an "initial scope" that "will be agreed upon by separate cover;" and
- prepare a report that would "not be advocacy document," but would, according to Vinson & Elkins, be an "objective 'warts and all' report."⁹

Days before the City Council approved hiring Vinson & Elkins, former City Attorney Casey Gwinn issued an e-mail to Vinson & Elkins Partner Paul Maco stating that some City officials had raised concerns over the existence of a potential conflict by the firm completing an investigation while, at the same time, representing the City to the SEC. Gwinn wrote:

Pat [Frazier] and Ed [Ryan] also raised questions about your representation of the City since you were already assisting City staff on these issues. I don't see the legal issues, but Pat [Frazier] made the point that they were going to have you do an internal review and now you are 'investigating' the staff you have been working with.¹⁰

Maco responded that no conflict existed. He wrote in an 16 February 2004 e-mail:

We see no conflict in our serving in both the report capacity and as your SEC lawyer, rather it is complementary and will avoid doubling up cost. For example, we would not be able to do a thorough report unless we reviewed everything turned over to the SEC in any event. We would also be well positioned to engage in negotiations with the SEC staff upon completion of the report.¹¹

⁸ Request for City Manager Action; Engagement letter dates 22 January 2004; and Auditor's Certificate number 2400800. (Exhibit 6)

⁹ Request for City Manager Action; Engagement letter dates 22 January 2004; and Auditor's Certificate number 2400800. (Exhibit 6)

¹⁰ 16 February 2004 e-mail from former-City Attorney Casey Gwinn to Vinson & Elkins Partner Paul Maco. Subject: "Re: Attorney-Client Communication". (Exhibit 7)

¹¹ 16 February 2004 e-mail from Vinson & Elkins Partner Paul Maco to former City Attorney Casey Gwinn. Subject: "Re: Attorney-Client Communication". (Exhibit 7)

Vinson & Elkins never delivered the promised “initial scope” for its investigation. Rather, the firm immediately started work and began billing the City, with the letter of engagement as its only agreement and written directive. Its first bill, submitted on 12 March 2004, after a month of work, was more than \$149,987.22, just \$12.78 less than the full contract amount.¹²

After discovering a series of errors by the auditing firm Caporicci & Larson on the 2002 CAFR, the City severed the business relationship with that firm. Although Caporicci & Larson had completed an audit for fiscal year 2003, the City hired KPMG to re-do the 2003 audit.¹³

Meanwhile, the City Council appropriated an additional \$350,000 in April 2004 for V&E to complete the report and for continued representation before the SEC.¹⁴ The City Council appropriated an additional \$800,000 for Vinson & Elkins’ services in May 2004. Of that amount, \$500,000 was to additionally compensate Vinson & Elkins to complete the report and \$300,000 more to pay for representation of the City and a production of its documents before the SEC and the U.S. Attorney’s Office. At this time, the total cost of the legal services was not to exceed \$1.3 million.¹⁵

The City then tasked Vinson & Elkins to work with KPMG to examine the old financial data, ensure that all issues related to receiving an unqualified audit were addressed, and to identify and implement policies to ensure the errors would not occur in the future.

KPMG issued a letter to the City on 9 August 2004 that acknowledged the City’s directive for the firm to work with Vinson & Elkins. KPMG Partner Steven DeVetter wrote:

As indicated in our engagement letter dated April 13, 2004, we will not issue our auditors’ report until a determination is made that the investigation being conducted by V&E is sufficient and complete. We acknowledge V&E’s effort and cooperation in explaining the process they are undertaking to KPMG.¹⁶

¹² 12 March 2004 invoice from Vinson & Elkins to Assistant City Attorney Les Girard; 1 April 2004 City of San Diego Request for Direct Payment; 12 March 2004 Outside Counsel Income Routing Slip. (Exhibit 8)

¹³ 13 April 2004 letter from KPMG Partner Steven DeVetter to Lisa Irvine, director of the City’s Financial Management Department. (Exhibit 9)

¹⁴ 12 April 2004. Resolution number 299077. Request for Council action; Auditor’s Certificate number 2400977. (Exhibit 10)

¹⁵ 7 June 2004. San Diego City Council Resolution number 299313; 27 May 2004 Request for Council Action; Auditor’s Certificate number 2401131. (Exhibit 11)

¹⁶ 9 August 2004 letter from KPMG Partner Steven DeVetter to Assistant City Attorney Les Girard. RE: Investigation. (Exhibit 12)

DeVetter also stated that the investigation being performed by Vinson & Elkins must include an analysis of whether any laws were violated.¹⁷ DeVetter specifically asked Vinson & Elkins to answer a series of questions, including in pertinent part:

Did the SDCERS Board breach their fiduciary duty by allowing the City to underfund the plan in exchange for additional benefits for current employees and could this action have been in violation of any laws?...Did the City violate the City Charter by failing to fund its retirement plan as required by the City Charter?...Did the SDCERS Board and/or the City violate the California Constitution by allowing the City to intentionally underfund the Plan?...Was undue influence placed on the actuary to change assumptions to reduce the shortfall of the City's contribution compared to the ARC, and, if yes, at whose direction and what action does the City plan to take to rectify this action, if applicable?¹⁸

KPMG included with the letter a copy of the American Institute of Certified Public Accountants AU § 317, called "Illegal Acts by Clients."¹⁹ The section outlines a set of specific accounting and investigative steps required to identify any illegal acts, the process used to carry out the acts, and the individuals who committed the acts.

By the end of August, the City Council authorized the expenditure of another \$700,000 for Vinson & Elkins, increasing the total cost of legal services to an amount not to exceed \$2 million.²⁰

The relationship between V&E and KPMG did not go as planned. Less than one month after KPMG's letter was written on 9 August 2004, the firm issued another letter to the City on 1 September 2004 citing specific problems with the progress of Vinson & Elkins' work. Specifically, KPMG was concerned that the investigation failed to meet the comprehensive requirements outlined in previous communications. DeVetter wrote:

[W]e think it is fair to say that over [the last few months] we have expressed our concerns about the scope of the investigation as it has been described to us...[W]e remain concerned that the scope of the investigation may not be sufficient to

¹⁷ 9 August 2004 letter from KPMG Partner Steven DeVetter to Assistant City Attorney Les Girard. RE: Investigation. (Exhibit 12)

¹⁸ 9 August 2004 letter from KPMG Partner Steven DeVetter to Assistant City Attorney Les Girard. RE: Investigation. (Exhibit 12)

¹⁹ American Institute of Certified Public Accountants AU § 317. Illegal Acts by Clients. (Exhibit 13)

²⁰ 27 September 2004. Resolution number 299693; Request for Council Action dated 24 August 2004; Auditor's Certificate number 2500255. (Exhibit 14)

enable us to conclude that the City has adequately addressed certain issues pertinent to our audits...

[W]ithout in any way prejudging what our reaction to the final report will be, you should be aware that, if following our review of the V&E report we conclude that the V&E report is not sufficient to resolve all of the issues we face in the audit, we may advise you that additional investigative procedures may be necessary before KPMG can complete its work.²¹

KPMG effectively communicated its concern about the scope of the investigation to all parties in no uncertain terms. Thus, it is absolutely clear that Vinson & Elkins had substantial and repeated notice of KPMG's expectations.

Vinson & Elkins issued its report titled, "Report on Investigation: The City of San Diego, California's Disclosure Obligations to Fund the San Diego City Employees' Retirement System and Related Disclosure Practices," on 16 September 2004.²² The report outlined two different agreements between the City Council and the SDCERS Board of Administration ("Board") as the primary sources of the pension deficit. These agreements provided for the SDCERS Board to accept underfunding of the retirement system in exchange for the City Council's agreement to grant enhanced pension benefits for City employees. The first deal, commonly referred to as Manager's Proposal I (MPI), was approved in 1996. The second deal, called Manager's Proposal II (MPII), was approved in 2002.

The report found that a series of disclosure violations had occurred. However, the report found "no evidence of affirmative deception," noting that those "individuals responsible for the City's disclosure lacked both motive and opportunity to mislead." Vinson & Elkins further found "no evidence that any City employees were personally enriched as a result of disclosure decisions in which they participated."²³ In the report's conclusion, Vinson & Elkins found it "difficult to attribute the City's failure to fully and accurately describe [this] matter to intentional misconduct on the part of individual employees."²⁴ In essence, Vinson & Elkins cleared all

²¹ 1 September 2004. Letter from KPMG Partner Steven DeVetter to Assistant City Attorney Les Girard. Re: "Follow-up from meeting on August 27, 2004". (Exhibit 15)

²² 16 September 2004. Vinson & Elkins: Report on Investigation: The City of San Diego, California's Disclosure Obligations to Fund the San Diego City Employees' Retirement System and Related Disclosure Practices 1996-2004 with Recommended Procedures and Changes to the Municipal Code. (Exhibit 16)

²³ 16 September 2004. Vinson & Elkins: Report on Investigation: The City of San Diego, California's Disclosure Obligations to Fund the San Diego City Employees' Retirement System and Related Disclosure Practices 1996-2004 with Recommended Procedures and Changes to the Municipal Code. P. 6. (Exhibit 16)

²⁴ 16 September 2004. Vinson & Elkins: Report on Investigation: The City of San Diego, California's Disclosure Obligations to Fund the San Diego City Employees' Retirement System

individuals from purposefully committing any illegal activities but failed in any meaningful way to substantiate the basis for its conclusion.

KPMG immediately voiced concerns about the quality of the investigation and the resulting conclusions. The firm issued a letter to the City on 11 October 2004 that stated that the report was insufficient to meet professional auditing standards and that an “illegal acts” analysis was necessary for the audit to be completed. DeVetter wrote,

[W]e do not believe that the City of San Diego (“City”) has conducted an adequate investigation in order to conclude that likely illegal acts have not occurred, or that appropriate remedial action has been taken. Such an investigation is necessary in order for an auditor to complete an audit in accordance with generally accepted auditing standards and *Government Auditing Standards*.²⁵

Vinson & Elkins immediately sought to downplay the criticism. Paul Maco, partner for Vinson & Elkins, issued a response to Assistant City Attorney Leslie Girard on 28 October 2004, stating that KPMG “fail[ed] to provide any practical guidance as to what additional investigative procedures [KPMG] would find satisfactory” for the completion of the 16 September 2004 report.²⁶

The City Attorney believes that sufficient evidence exists to demonstrate that KPMG issued detailed “practical guidelines” for Vinson & Elkins to follow.

KPMG reasserted the need for an illegal acts investigation in a 29 October 2004 letter to former Mayor Dick Murphy.²⁷ DeVetter, in the letter, explicitly asked the City to contract with a firm other than Vinson & Elkins to complete this work. DeVetter wrote,

If the City is prepared to proceed with an appropriate investigation, then we urge you to consider retaining counsel other than V&E [Vinson & Elkins] to do so. The positions asserted in, and oppositional tone of, Mr. Maco’s letter raises questions about V&E’s willingness or ability in these circumstances to complete the investigation of, and reach conclusion on, the audit-critical questions posed in

and Related Disclosure Practices 1996-2004 with Recommended Procedures and Changes to the Municipal Code. P. 164. (Exhibit 16)

²⁵ 11 October 2004. Letter from Steven G. DeVetter to Leslie J. Girard. Re: City of San Diego Fiscal Year 2003 Audit. (Exhibit 17)

²⁶ 28 October 2004. Letter from Vinson & Elkins Partner Paul Maco to Assistant City Attorney Leslie Girard. Re: Additional Investigation. (Exhibit 18)

²⁷ 29 October 2004. Letter from KPMG Partner Steven DeVetter to Assistant City Attorney Leslie Girard. Re: Follow-up from meeting on August 27, 2004. (Exhibit 19)

our prior oral and written communications and to do so with an objective and independent manner.²⁸

Despite KPMG's specific request, the City extended the contract with Vinson & Elkins to complete the investigation and to provide its analysis in a second report. While the prior resolutions adopted by the City required the City Attorney to enter into a contract with Vinson & Elkins, the City Manager's action of December 2, 2004, required the contract to be managed by the City Manager's office. Furthermore, Vinson & Elkins was to report directly to the Mayor with respect to the additional investigation.²⁹

A new City Attorney, Michael Aguirre, was elected on 2 November 2004, in a tight election that required a complete vote count and took weeks to certify.³⁰

Just days after the election results were announced, the City Council approved a resolution, on 23 November 2004, which expanded the scope of Vinson & Elkins' work to include "additional investigative services (are) now required to facilitate the completion of the audit of the City's FY 2003 basic financial statements" and stating that "additional contract authorization is necessary and appropriate to permit V&E to perform the additional investigation and to continue to provides representation of the City before the SEC".³¹

The new City Attorney took office on 6 December 2004. The new City Attorney immediately announced an investigation³² and subsequently released a series of Interim Reports outlining alleged illegal acts that occurred in the approval of the Manager's Proposal I in 1996

²⁸ 29 October 2004. Letter from KPMG Partner Steven DeVetter to Assistant City Attorney Leslie Girard. Re: Follow-up from meeting on August 27, 2004. (Exhibit 19)

²⁹ Request of City Manager Action dated 22 October 2004; Retainer Agreement on 15 October 2004; and Auditor's Certificate number 2500413. (Exhibit 20)

³⁰ Moran, Greg. "Aguirre wins S.D. city attorney race | Victory is his first in five tries for office." *San Diego Union-Tribune*. 20 November 2004. (Exhibit 21)

³¹ San Diego City Council Resolution-299880 adopted on 23 November 2004. (Exhibit 22)

³² 9 December 2004. Press release from the office of City Attorney Michael Aguirre. "Statement from City Attorney Michael J. Aguirre: Financial Disclosure Practices Investigation, and Decision Not to Join San Diego's Retirement System." (Exhibit 23)

and Manager's Proposal II in 2002. Interim Report #1 was issued on 14 January 2005³³ and Interim Report #2 was issued on 9 February 2005.³⁴

The City Council then hired Los Angeles-based forensic accounting firm Kroll Inc. to reconcile the findings of Vinson & Elkins and the City Attorney. Troy Dahlberg, managing director of Kroll, issued a letter of engagement to the City on 10 February 2005. The Kroll scope of services was stated as follows:

"The City has requested that Kroll (1) receive, review and evaluate the findings of the investigations by VINSON & ELKINS and the City Attorney. The City has also requested Kroll provide consulting assistance in assessing internal control deficiencies affecting matters discussed in the investigation reports."³⁵

The letter mandates that Kroll's work must satisfy KPMG's audit requirements. Kroll specifically requested unfettered access to personnel and documents of the City, SDCERS, Vinson & Elkins, the City Attorney, and other potentially involved parties.³⁶ The City Council approved the Kroll contract at its 14 February 2005 meeting.³⁷ Kroll renamed itself The Audit Committee for these purposes.

At the 14 February 2005 City Council meeting, Lynn Turner, a consultant for Kroll, explained that Kroll would take the reports issued by the City Attorney and Vinson & Elkins, compare the data and findings, and issue its findings to KPMG.³⁸

³³ 14 January 2005. Interim Report No. 1 | Regarding Possible Abuse, Fraud, and Illegal Acts by San Diego City Officials and Employees. Report of the San Diego City Attorney Michael J. Aguirre. (Exhibit 24)

³⁴ 9 February 2005. Interim Report No. 2 | Regarding Possible Abuse, Fraud, and Illegal Acts by San Diego City Officials and Employees. Report of the San Diego City Attorney Michael J. Aguirre. (Exhibit 25)

³⁵ 10 February 2005 letter from Troy Dahlberg, managing director of Kroll, to Mayor Richard Murphy and San Diego City Council. Re: Independent Services for the City of San Diego. (Exhibit 26)

³⁶ 10 February 2005 letter from Troy Dahlberg, managing director of Kroll, to Mayor Richard Murphy and San Diego City Council. Re: Independent Services for the City of San Diego. (Exhibit 26)

³⁷ 14 February 2005 meeting of the San Diego City Council. (Exhibit 27)

³⁸ Transcript of Lynn Turner's presentation at the 14 February 2005 meeting of the San Diego City Council. (Exhibit 28)

On 1 March 2005, the City Council authorized the expenditure of another \$1.2 million for the work that Vinson & Elkins was performing. These funds, according to the language the City Council approved in the Resolution, were to come from the City's Enterprise Funds.³⁹

Kroll and Vinson & Elkins began working together almost immediately. On 6 May 2005, Kroll issued a letter to City Manager P. Lamont Ewell explaining that materials compiled by Vinson & Elkins in the course of its investigations were useful. The letter was vague, however, as to whether Vinson & Elkins would issue a second report.

Questions have been raised as to whether or not Vinson & Elkins' work program will result in another report from that firm. The independent auditors have not specifically requested that from the Audit Committee.⁴⁰

Despite noting the working relationship with Vinson & Elkins, Kroll continued to stress its independence.⁴¹

The letter suggests that Kroll was managing the work of Vinson & Elkins – a significant departure from Kroll's contractual obligation to analyze the Vinson & Elkins report. It is important to note that Vinson & Elkins' contact extension with the City required the production of a follow-up investigative report that would meet the standard of the American Institute of Certified Accountants § 317.

Kroll sent a letter to the City Council on 10 June 2005 further outlining its relationship with Vinson & Elkins.⁴² Dahlberg wrote that the Kroll team had been reviewing the work plan laid out by Vinson & Elkins; examining documents collected, and would "provide V&E guidance as to the structure and format for presenting their findings and work product to KPMG." The letter also stated that Vinson & Elkins will issue a "summary memorandum" which will serve as a second report.⁴³

On 1 August 2005, Dahlberg appeared before the City Council to request the Council waive the attorney-client privilege on documents that Vinson & Elkins obtained during its

³⁹ San Diego City Council Resolution-300182 adopted on 1 March 2005. (Exhibit 29)

⁴⁰ 6 May 2005 letter from Troy Dahlberg, managing director of Kroll Inc., to City Manager P. Lamont Ewell. Re: Audit Committee – Investigation Status. (Exhibit 30)

⁴¹ 6 May 2005 letter from Troy Dahlberg, managing director of Kroll Inc., to City Manager P. Lamont Ewell. Re: Audit Committee – Investigation Status. (Exhibit 30)

⁴² 10 June 2005 letter from Troy Dahlberg, managing director at Kroll, to Mayor Richard Murphy. Re: Audit Committee – Investigation Status Update. (Exhibit 31)

⁴³ 10 June 2005 letter from Troy Dahlberg, managing director at Kroll, to Mayor Richard Murphy. Re: Audit Committee – Investigation Status Update. (Exhibit 31)

investigation. During Dahlberg's presentation, Councilmember Donna Frye asked a series of questions about the documents for which the privilege would be waived and to whom they would be presented. Dahlberg responded that the information was going to be presented to the SEC and KPMG. Dahlberg added that Kroll possessed in its ninth floor City Hall office a memorandum from Vinson & Elkins explaining the findings of its second investigation.⁴⁴ Both Frye and the City Attorney criticized the firms for not alerting the City Council to the existence of the draft Vinson & Elkins memorandum and requested a copy. Dahlberg provided a copy of the 116-page report to the Council and City Attorney.⁴⁵

The new Vinson & Elkins memorandum, released to the public in the following days, found that the City failed to follow General Accepted Accounting Principles ("GAAP"). The report, however, cited no intentional wrongdoing or violations of law on the part of any individual City employees or City officials.

The additional evidence in our view, falls short of establishing that the City's flawed disclosure resulted from intentional wrongdoing on the part of City employees. The record does not indicate that any City employees, including its senior officers, suspected at any time that they were engaging in conduct that might be prohibited by law. Nor is there Available Evidence that any City employees consciously misled the City's auditors, outside counsel, or, indeed, anyone else.⁴⁶

The report also concluded that:

The most damaging insight to come from this phase of the investigation is that certain officials consciously avoided bringing negative information to the attention of the bond rating agencies. There is no indication that they made false statements to the rating agencies, or evaded direct requests for information.⁴⁷

As illustrated by California Civil Jury Instructions, 12.31, actual knowledge that representations are false and/or misleading is not required to demonstrate the act of fraud and/or deceit. Indeed, "false representations made recklessly and without regard for their truth in order to induce action by another are the equivalent of misrepresentations knowingly and intentionally uttered."⁴⁸

⁴⁴ Transcript of the 1 August 2005 meeting of the San Diego City Council. (Exhibit 32)

⁴⁵ 15 July 2005. Vinson & Elkins report: Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals. P.117. (Exhibit 33)

⁴⁶ 15 July 2005 V&E report, p. 117.

⁴⁷ 15 July 2005. Vinson & Elkins report: Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals. P.117. (Exhibit 33)

⁴⁸ Engalla v. Superior Court (1997) 15 Cal.4th 951, 974, quoting Yellow Creek Logging Corp. v. Dare (1963) 216 Cal.App.2d 50, 55.)

By this time, the City Attorney had released six Interim Reports alleging illegal acts by City officials surrounding Manager's Proposals I and II. The six reports contained footnotes and evidence to substantiate each claim and contained extensive appendices containing all footnoted documents.

On 6 January 2006 the U.S. Attorney's Office announced its indictments of three former trustees of the San Diego City Employee's Retirement System: Ron Saathoff, president of the San Diego Firefighters Association Local 145; Cathy Lexin, former Human Resources Director for the City; and Terri Webster, former assistant auditor and comptroller for the City. The indictments also named former SDCERS Administrator Lawrence Grissom, and Loraine Chapin, general counsel at SDCERS.⁴⁹

III.

VINSON & ELKINS FAILED TO FULFILL CONTRACTUAL AND FIDUCIARY DUTIES OWED TO CITY OF SAN DIEGO

Vinson and Elkins was under contract with the City of San Diego to produce a report that would satisfy concerns Indicated by KPMG. The evidence provided bellow will illustrate that:

- Vinson & Elkins Compromised its Independence
- Vinson & Elkins Failed to Complete Investigation Required by AU § 317

A. VINSON & ELKINS COMPROMISED ITS INDEPENDENCE

The primary objective of Vinson & Elkins' work for the City of San Diego was to create a completely objective report that would be independent in its preparation and unflinching in its criticism of the City.⁵⁰ However, Vinson & Elkins' independence was questionable as early as February 2005 and invoices submitted by Vinson & Elkins for May indicate that members of Kroll's team were working directly with Vinson & Elkins on preparing and drafting the law firm's second report. Indeed, evidence exists that Vinson & Elkins abdicated its independence in its relationship with Kroll.

⁴⁹ 6 January 2006. United States District Court Southern District of California January 2004 Grand Jury: United States of America, Plaintiff, v. Ronald Saathoff (1), Cathy Lexin (2), Teresa Webster (3), Lawrence Grissom (4), Lorraine Chapin (5), Defendants. Criminal Case No. 06CR0043BEN. Indictment: Title 18, U.S.C., Sec. 371 – Conspiracy to Commit Wire and Mail Fraud; Title 18, U.S.C., Secs. 1343 and 1346 – Wire Fraud; Title 18, U.S.C., Secs. 1341 and 1346 – Mail Fraud; Title 18, U.S.C., Sec. 2 – Aiding and Abetting. 15 July 2005. Vinson & Elkins report: Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals. P.117. (Exhibit 34)

⁵⁰ Request for City Manager Action; Engagement letter dates 22 January 2004; and Auditor's Certificate number 2400800. (Exhibit 6)

On 16 February 2005, Lynn Turner sent an e-mail to City Manager Ewell explaining that Vinson & Elkins would, in effect, report directly to Kroll. Turner wrote, "Lamont – just to let you know I had a good call with Paul Maco yesterday and was able to communicate with Les Hand who was in NYC. Paul and I set up a reporting arrangement whereby he will report to us..."⁵¹ The message was sent just days after the City Council approved the letter of engagement with Kroll in February and months before Vinson & Elkins released its second report. The message shows that Vinson & Elkins and Kroll were working closely since the beginning of Kroll's work for the City.

In late May, Richard Sauer, a partner at Vinson & Elkins, spent 10 hours working on a "Draft report regarding securities law violations." During this time – between 24 May 2005 and 31 May 2005 – Paul Maco spent more than 30 hours meeting with Kroll representatives. Sauer then met with the Kroll team on 27 May 2005 for 5.50 hours for "team conferences" and "draft memo." Maco then met with the Kroll team on 31 May 2005 for 2.5 hours to "continue report preparation."⁵² Despite the work indicated on the billings, the second report from Vinson & Elkins would not be released until August.

B. VINSON & ELKINS FAILED TO COMPLETE INVESTIGATION REQUIRED BY AICPA § 317

The second Vinson & Elkins report failed to meet the requirements of AU § 317, and meeting these requirements was explicitly required by KPMG. The standards specifically state:

.10 When the auditor becomes aware of information concerning a possible illegal act, the auditor should obtain an understanding of the nature of the act, the circumstance in which it occurred, and sufficient other information to evaluate the effect on the financial statement. In doing so, the auditor should inquire at a level above those involved...

.11 The additional audit procedures considered necessary, if any, might include procedures such as the following:

- a. Examine supporting documents, such as invoices, canceled checks, and agreements and compare with accounting records.
- b. Confirm significant information concerning the matters with the other party to the transaction or with intermediaries, such as banks or lawyers.
- c. Determine whether the transaction has been properly authorized.
- d. Consider whether other similar transactions or events may have occurred, and apply procedures to identify them.

⁵¹ 16 February 2005. E-mail from Lynn Turner to P. Lamont Ewell. Subject: San Diego. (Exhibit 35)

⁵² 7 June 2005. Vinson & Elkins invoices to P. Lamont Ewell. (Exhibit 36)

1. Failure to Analyze City Council Member and Mayor Hard Drives

Neither of the investigative reports prepared by Vinson & Elkins included an analysis of the computer hard drives of City Council members or their staffs, according to Paul Maco at the 9 August 2005 meeting of the City Council.⁵³

2. Failure to Investigate Blue Ribbon Committee

Vinson & Elkins' second report also failed to properly track down information following the questioning of key witnesses closely involved with the pension and the alleged failure to disclose information in financial statements. Specifically, the report discussed the Mayor's Blue Ribbon Committee on Finances report but failed to thoroughly investigate several inconsistencies between the final report and information that was known during its preparation. Vinson & Elkins describes the Blue Ribbon Committee report as, "The first significant warning as to the possible long-term consequences of the City's attempts to minimize its contributions and reported liabilities to SDCERS."⁵⁴ The Blue Ribbon Committee report was presented to the City Council's Government, Rules and Finance Committee on 27 February 2002.⁵⁵

San Diego businessman Richard Vortmann was responsible for studying and writing the section of the Blue Ribbon Committee report focusing on the financial status of the pension system. Overseeing the work of Vortmann on the report were former City Auditor Ed Ryan and former Acting City Auditor Terri Webster. The second Vinson & Elkins report contains correspondence between Webster and Ryan illustrating repeated attempts to soften Vortmann's negative financial assessment.

Vinson & Elkins, however, did not adequately investigate the extent of the communications, or examine potential legal implications. Specifically, Vinson & Elkins failed to ascertain whether Ryan and Webster acted at the direction of other City officials.

In the Blue Ribbon Committee report, Vortmann correctly identified potential problems in the pension system including a growing liability for retiree medical care and the artificial health of the pension's funded ratio. Vortmann's report stated that, at the time, the funded ratio of SDCERS was 97 percent.

That information was inaccurate at the time of the presentation because the newest valuation for the SDCERS had been released to the Board on 12 February 2002 which pegged the funded ratio at 89 percent. The 97 percent funded number represented financial information

⁵³ Transcript of the 9 August 2005 meeting minutes of the San Diego City Council. (Exhibit 37)

⁵⁴ Vinson & Elkins draft report titled "Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals. 15 July 2005. P. 45-50. (Exhibit 38)

⁵⁵ 27 February 2002. Blue Ribbon Committee Report on City of San Diego Finances. (Exhibit 39)

as of June 2000, while the 89 percent number reflected the newer, more accurate figures as of June 2001. The June 2001 valuation reflected a stunning increase in the pension's unfunded liability.

Vortmann was a member of the SDCERS Board in the months immediately preceding the presentation of the Blue Ribbon Committee Report and was privy to the new valuation, but made no effort to include the information before the hard copy of the report had been finalized and approved by the Rules Committee. Vinson & Elkins interviewed Vortmann and Terri Webster, former acting auditor for the City of San Diego, who oversaw the production of the report, about the failure to include the new numbers.

In an interview with VINSON & ELKINS, Mr. Vortmann stated that he could not recall whether he received and read the FY 2001 actuarial report prior to the publication date of the Blue Ribbon Committee Report but, in any event, found that it simply confirmed his view that FY 2001 would bring further decline in the funded level. Thus, in Mr. Vortmann's view, it did not materially affect the overall presentation of the report. Ms. Webster told V&E that she remembered some discussion among members of the Blue Ribbon Committee about including the updated number, but believes this was not done because, among other things, the actuary's report had not yet been accepted by the SDCER Board.⁵⁶

The Vinson & Elkins report, however, also included a letter that Vortmann had written on 18 February 2002 to Frederick Pierce IV, then president of the SDCERS Board, where the new actuarial valuation was discussed. Therefore, this information was discussed by Vortmann in a letter to Pierce nearly two weeks before the Blue Ribbon Committee Report was released but was not included in the Report. Vinson & Elkins and Kroll, who oversaw the writing of the second V&E Report, failed to adequately investigate why the information was not presented to the City Council Rules Committee.⁵⁷

The City Attorney believes that the newest information regarding the decreasing financial health of the pension system should have been included in the report as stated in the City Attorney's Interim Report #2.

The second Vinson & Elkins report also overlooked an important piece of evidence that was subsequently discussed in the City Attorney's Interim Report #2. Interim Report #2, released on 9 February 2005, identified an e-mail exchange between Ed Ryan, Terri Webster, and two of the City's labor negotiators, Dan Kelly and Mike McGhee. The topic of the correspondence is the "presidential benefit" that Ron Saathoff, as president of San Diego Firefighters Union Local 145, would receive as part of the Manager's Proposal II deal. In

⁵⁶ Vinson & Elkins draft report titled "Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals". 15 July 2005. P. 44-50. (Exhibit 38)

⁵⁷ Vinson & Elkins draft report titled "Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals". 15 July 2005. P. 44-50. (Exhibit 38)

addition to being the union president, Saathoff was also a member of the SDCERS Board. In short, the e-mail illustrates that Saathoff, the City and the retirement board members were all aware that the boosting of retirement benefits was contingent upon the SDCERS Board allowing the City to underfund the pension. McGhee wrote to Ryan, Webster and Kelley, "I assure you that Ron is well aware of the contingent nature of the benefits."⁵⁸

This information was not even mentioned in the second Vinson & Elkins report. In fact, the report stated that no evidence existed to establish a quid pro quo or contingent arrangement in the passage of Manager's Proposal II. Vinson & Elkins wrote, "A link between MP2 and the Union Presidents' Resolution is not clearly established by the evidence available to us at this time. The San Diego District Attorney has charged Mr. Saathoff (and others) with a conflict of interest in voting in favor of MP2, in part due to an alleged link between that measure and the union presidents' benefit."⁵⁹

The complete failure to identify and discuss this factual finding in the illegal acts analysis demonstrates Vinson & Elkins' failure to satisfy its contractual obligation to provide an objective report.

3. Failure to Analyze Electronic Documents Provided by NTI Breakwater

In order to make the production of documents more efficient, Vinson & Elkins used electronic discovery software from NTI Breakwater to create an electronic document repository, which was maintained by Applied Discovery, a subsidiary of Lexis-Nexis.

The City's e-mail system uses a software program called GroupWise, made by Novell Inc. This software is proprietary and GroupWise emails cannot be viewed by other computer programs.

NTI Breakwater was hired to convert the GroupWise files to ones that could be opened and viewed by other computer programs.⁶⁰ The converted files were placed in a database accessible to KPMG and federal investigators. In this database, the documents could be opened and viewed.

As early as January 2005, officials at Applied Discovery, KPMG and Vinson & Elkins realized that some of the attachments to documents had not been converted and placed in the database. In other words, if an e-mail, or "parent," had an attachment, or "child," the parent

⁵⁸ 21 May 2002 E-mail from Labor Relations officer Mike McGhee to Ed Ryan, city auditor; Terri Webster, assistant city auditor; and Dan Kelley, labor relations manager. (Exhibit 40)

⁵⁹ Vinson & Elkins draft report titled "Potential Violations of the Federal Securities Laws by the City of San Diego and Associated Individuals. 15 July 2005. P 60-63. (Exhibit 41)

⁶⁰ 22 November 2004. City of San Diego consulting engagement agreement with NTI Breakwater. (Exhibit 42)

would appear in the Applied Discover database but the child was missing. Kelli Clark, an account manager at Applied Discovery, spotted the issue and forwarded the information in an e-mail:

I had our production team look into doc 206722 at KPMG's request. When our team looked at the pre-converted document, the links to the attachments were "dead." Hence, the attachments are not extracted and linked to the e-mail on the ORA. Additionally, when we look at doc #125481 (the number of the attachment that you provided today) there is no evidence that this document is an attachment to any other doc in the system.⁶¹

Investigators at the SEC had already identified this issue according to an e-mail sent from Ben Lippard, an attorney at Vinson & Elkins to Paul Maco. Lippard wrote:

There was only one issue of any real importance on the call today – the SEC was concerned about the fact that from applied discovery database you can't tell which file attachments belong to which emails. I have instructed Kelli to consult with Anton about a technical fix to this issue, which it seems likely they will insist on.⁶²

This was a problem because the SEC and KPMG had both repeatedly asserted the need to see all documents requested to ensure that alleged improprieties that were responsible for the City's current financial difficulties would not happen again. If some of the e-mails and other electronic documents were not available, the investigation could not be adequately completed.

The problem was solved by Applied Discovery and NTI Breakwater on 2 May 2005 and a solution was presented to KPMG and the SEC in May. Kelli Clark wrote, "Ok. FYI – I just got word from our tech department that the family groups work is complete now. Whenever you give the go ahead, we are ready to begin the transfer."⁶³

City Manager Lamont Ewell released a memo on 8 September 2005 stating that Vinson & Elkins had failed to review more than 57,000 files of the 160,000 relevant documents.⁶⁴ Ewell wrote that technology had broken down and blamed Vinson & Elkins for overseeing the maintenance of the issue. Ewell wrote:

⁶¹ 10 January 2005. E-mail from Kelli Clark to Ben Lippard. (Exhibit 43)

⁶² 8 February 2005. E-mail from Ben Lippard to Paul Maco. Carbon-copied to Rick Sauer and William Lawler. Subject: Update on SEC call. (Exhibit 44)

⁶³ 2 May 2005. E-mail from Kelli Clark to Ben Lippard. Subject: RE: Transfer of data to a new database for the SEC. (Exhibit 45)

⁶⁴ 8 September 2005 letter from City Manager P. Lamont Ewell to Paul Maco, partner for Vinson & Elkins. (Exhibit 46)

The failure to include these files on the database has delayed the City's production of documents to the SEC and the United States Attorney's office. In addition, this error has caused the City to incur significant costs in having the missing files restored, and costs associated with a complete review of emails required by the Audit Committee, in addition to the attorneys' fees and expenses associated with creating and reviewing the original database.

It is my belief that V&E [Vinson & Elkins] was responsible for providing instructions to and supervising the work of ADI as part of its investigation and report to the City on disclosure matters.⁶⁵

The next day, on 9 September 2005, Scott Nagel, the Vice President of Applied Discovery, sent a letter to Lamont Ewell stating that the problems had been identified in January and corrected in June.⁶⁶ Nagel said that the staff of Applied Discovery had notified the City that the problems were corrected and that the City did not want the corrections implemented. Specifically, Nagel wrote that the City ordered the corrections not to be implemented. Nagel wrote:

Upon discovery of this issue in January, ADI offered to resolve the issue. At the time, ADI was told that the resolution it offered was unnecessary for purposes of the review work being performed. Later, in the April/May timeframe, ADI was asked to resolve part of the issue that had been created (i.e., repairing links between documents already in the database) for purposes of preparing a production database for the City. ADI did so, and also offered to resolve the remainder of the issues (i.e., ensuring that all family members of relevant documents were also included in the database) by re-running searches on the City's behalf. ADI was told not to re-run the searches.⁶⁷

4. Failure to Report Problems with Outside Disclosure Counsel

For two decades Orrick Herrington & Sutcliffe ("Orrick") has served as the City's outside bond and disclosure counsel on many of the City's bond offerings. Orrick has been the City's most-hired law firm to lead municipal financing efforts and to serve as disclosure counsel regarding the sufficiency of the City's disclosures.

⁶⁵ 8 September 2005 letter from City Manager P. Lamont Ewell to Paul Maco, partner for Vinson & Elkins. (Exhibit 46)

⁶⁶ 9 September 2005. Letter from Scott Nagel, vice president of Applied Discovery, to P. Lamont Ewell. (Exhibit 47)

⁶⁷ 9 September 2005. Letter from Scott Nagel, vice president of Applied Discovery, to P. Lamont Ewell. (Exhibit 47)

During seven of those years, all of the City's Official Statements contained a nearly identical pension disclosure in Appendix A. Under the heading "PENSION PLAN," the text stated:

State legislation requires the City to contribute to [SD]CERS at rates determined by actuarial valuations.

Vinson & Elkins interviewed Paul Webber, an Orrick attorney who served as bond and disclosure counsel for many City bond offerings. When asked, Webber was not able to identify the state legislation to which this sentence refers. Vinson and Elkins' report is silent on how Webber and Orrick could not understand their own disclosure statement.

Rather than explore the obvious problem with Orrick's disclosure statements, Vinson & Elkins accepted as true Orrick's denial of knowledge of the pension underfunding before the 5 September 2003 e-mail from Diann Shipione to Lawrence Grissom (with copies to Dick Murphy, Rick Roeder and Fred Pierce) alleging serious disclosure problems with City bond offerings.

The evidence available to Vinson & Elkins showed undeniably that Orrick knew well before September 2003 that the City was not complying with the legal requirements on funding its pension obligations. For example, Orrick obtained the SDCERS pension system's actuarial valuation for 2001, wherein the actuary explicitly stated that the City was not funding SDCERS based on actuarially required rates. The valuation states:

Overall, the financial condition of the retirement system continues to be in sound condition in accordance with actuarial principles of level-cost financing. However, we want all parties to be acutely aware that the current practice of paying less than the computed rate of contribution or pickup will help foster an environment of additional declines in the funding ratios in absence of healthy investment returns.⁶⁸

This warning shows that the City's pension funding was materially different than what years of Orrick-prepared bond offerings declared was legally required.

Orrick not only possessed the 2001 valuation but, by March 2002, it pursued City staff with certain questions about its contents.⁶⁹ Orrick originally posed questions to Lakshmi Kommi, an analyst in the City's Financial Services Department. Webber admitted in an interview with Vinson & Elkins that "[h]e obtained some projections related to the UAAL from Ms. Kommi."⁷⁰

⁶⁸ 2001 San Diego City Employees' Retirement System Actuarial Valuation. P. 17. (Exhibit 48)

⁶⁹ 18 March 2002. E-mail from Patrick Lane to Larry. Subject: "FY2001 actuarial [sic] valuation". (Exhibit 49)

⁷⁰ 11 July 2004. Memorandum from Tim J. Deithloff to Paul S. Maco. Re: "*City of San Diego*; Interview of Paul Webster". (Exhibit 50)

Mr. Webber also admitted to Vinson & Elkins that he looked at the City's pension disclosures in 2002.⁷¹

Webber could not do the things he told Vinson & Elkins he did in 2002—review the UAAL projections and look at the City's pension disclosures—and not be aware that the City was underfunding the retirement system. Incredibly, Webber told V&E that Orrick did not discover the funding problem until September 2003, 18 months after Webber must have been aware of the problem. V&E was derelict in failing to question this glaring inconsistency regarding Webber and the Orrick firm.

The next year, in June or July 2003, Webber received the actuary's report, which included the SDCERS 30 June 2002 valuation. Webber admitted to Vinson & Elkins that he had the 2002 SDCERS valuation by June or July 2003—earlier than September 2003 when he acknowledged that Orrick was aware of the funding problem and six months before Shipione's e-mail.⁷² The 2002 valuation showed a UAAL of about \$700 million—nearly triple the year before. This time, Rick Roeder, the SDCERS actuary, declined to describe the pension fund as actuarially sound. Instead, he described the condition of SDCERS as “adequate”:

Overall, the financial condition of the retirement system is in adequate condition in accordance with actuarial principles of level-cost financing. However, all parties should be acutely aware that the current practice of paying less than the computed rate of contribution will help foster an environment of additional declines in the funding ratios in the absence of healthy investment returns.⁷³

Orrick admitted to Vinson & Elkins that it was in possession of the actuarial valuation in the summer of 2003 and therefore must have known that the pension underfunding was material and required disclosure.⁷⁵ Webber further admitted that he would have determined the City's pension underfunding to be material even if Diann Shipione had not exposed the problem:

Mr. Webber believed that even if Diann Shipione hadn't come along, he would have discovered the City's pension situation (both retirement benefits and post-

⁷¹ 11 July 1004. Memorandum from Tim J. Deithloff to Paul S. Maco. Re: “*City of San Diego*; Interview of Paul Webster”. (Exhibit 50)

⁷² 11 July 1004. Memorandum from Tim J. Deithloff to Paul S. Maco. Re: “*City of San Diego*; Interview of Paul Webster”. (Exhibit 50)

⁷³ 30 July, 2002 San Diego City Employees' Retirement System Annual Actuarial Valuation. P.17. (Exhibit 51)

⁷⁵ 11 July 1004. Memorandum from Tim J. Deithloff to Paul S. Maco. Re: “*City of San Diego*; Interview of Paul Webster”. (Exhibit 50)

retirement health care benefits) to be material because, if one were to look at the prospective amounts the City was paying in relation to their budget, there was no way the City could make 100% of the required payments.⁷⁶

Despite this, Webber also admitted to Vinson & Elkins that he did not discuss what he knew to be material information with anyone from the City:

[T]he problem with it [the nondisclosure of the rising UAAL] is that they didn't tell the market and didn't consider the consequences (which is that they would eventually have to pay the debt). Mr. Webber did not recall talking to anyone at the City about the aforementioned comments.⁷⁷

During that same year, and before Shipione's September 2003 e-mail, Orrick was tasked with analyzing and providing disclosure concerning the Gleason case. "Mr. Webber [himself] prepared a draft of the Gleason case disclosure based on the work of Luce Forward,"⁷⁸ a prominent San Diego law firm.

It is inconceivable that anyone could review the Gleason case, much less provide public disclosure regarding its import, without becoming aware of the City's underfunding of the pension.

It does not appear that Vinson & Elkins ever asked, much less followed up on, the question of why Orrick, possessing the knowledge it did, didn't act sooner, or why it had previously done nothing to correct the obvious incongruities in the bond offering documents, or why it claimed, apparently falsely, to be surprised by what it had supposedly learned for the first time in September 2003.

Perhaps the answer to these inquiries lies buried in Vinson & Elkins' own Report, where tucked away in footnote 350, is the following "disclosure":

Mr. Maco, a Vinson & Elkins partner who is also an author of this Report, had, prior to this time, provided Securities law advice to the City on a matter unrelated to the matters at issue here. He was asked by the City to also serve as a "sounding board" as the City prepared its pension disclosure [which was made on January

⁷⁶ 8 March 2004. Memorandum from Benjamin S. Lippard to Paul S. Maco. Re: "*City of San Diego*; Interview of Paul Webber". (Exhibit 52)

⁷⁷ 8 March 2004. Memorandum from Benjamin S. Lippard to Paul S. Maco. Re: "*City of San Diego*; Interview of Paul Webber". (Exhibit 52)

⁷⁸ 11 July 2004. Memorandum from Tim J. Deithloff to Paul S. Maco. Re: "*City of San Diego*; Interview of Paul Webster. (Exhibit 50). 8 March 2004. Memorandum from Benjamin S. Lippard to Paul S. Maco. Re: "*City of San Diego*; Interview of Paul Webber" Luce Forward Hamilton & Scripps is a prominent San Diego law firm. (Exhibit 52)

27, 2004, before V&E began its investigation] and [was] asked as to whether the expansive disclosure advocated by Mr. Webber was appropriate. He concurred with Mr. Webber's judgment⁷⁹

Thus, by Vinson & Elkins' own admission, even before it began its investigation, Vinson & Elkins had already served as Webber's "sounding board," leaving little room to wonder where Vinson & Elkins would end up after investigating Webber (and, by extension, itself).

IV.

ACTIONABLE MISCONDUCT BY VINSON & ELKINS

A. BREACH OF CONTRACT

The failures, omissions and shortcomings of Vinson & Elkins described in this Report fall squarely within a number of legally cognizable claims by the City. First, V&E breached its contracts with the City. Vinson & Elkins' consistent failure to comply with the terms of its Agreements with the City constitute actionable breach of contract.

Vinson & Elkins entered into at least two contractually binding Agreements for services with the City. These services included representation by Vinson & Elkins of the City in defense of the SEC investigation, the investigation and subsequent preparation of an objective and independent Report regarding the City's then – current and past financial disclosure practices; and then by extension of the City Council, the preparation of a second Report to correct the shortcomings of its initial Report ("Agreements"). Pursuant to these Agreements, Vinson & Elkins was required to comply with the applicable professional standards of care. Some of the more flagrant breaches of contract committed by V&E include:

- a. Failure to perform an investigation with an "initial scope" that "will be agreed upon by separate cover";
- b. Failure to prepare a Report that would "not be an advocacy document," but would be an "objective 'warts and all' report";
- c. Failure to prepare a second Report that adhered to the same objective and independent standards;
- d. Failure to perform work at a discount "in recognition of the governmental nature of the client";
- e. Charging the City for unnecessary work;

⁷⁹ 16 September 2004. Vinson & Elkins: Report on Investigation: The City of San Diego, California's Disclosure Obligations to Find the Can Diego City Employees' Retirement System and Related Disclosure Practices 1996-2004 with Recommended Procedures and Changes to the Municipal Code. p. 118. (Exhibit 53)

- f. Failure to limit the number of V&E partners and associate attorneys performing the work as specified;
- g. Failure to conduct an investigation into potential illegal acts by City and SDCERS; and
- h. Failure to conduct its investigation in a manner sufficient to meet the required professional auditing standards.

B. BREACH OF FIDUCIARY DUTY

Second, Vinson & Elkins breached its fiduciary duty to the City. As a law firm, Vinson & Elkins owed its client, the City, fiduciary duties of uncompromising loyalty. As the City's fiduciary, Vinson & Elkins was required to disclose all information material to the City's interests; was required to put the City's interests above its own; and was required to exercise the greatest diligence in protecting the City. The fiduciary duty of loyalty required Vinson & Elkins to place the interests of the City, its beneficiary, over any personal interest of the firm. To the contrary, Vinson & Elkins placed its own interests over the interests of the City.

Evidence included in this report clearly illustrates that Vinson & Elkins breached its fiduciary duty to the City by, among other things:

- a. Inducing the City to retain it on the pretext that it would complete the work in two months and for \$150,000 (when V&E knew that it would charge the City substantially more and take substantially longer to complete the work it planned on doing);
- b. Inducing the City to retain it to perform an independent investigation, when it had already formed specific opinions, and even advised the City's Disclosure Counsel on recommended courses of action, before it began its investigation;
- c. Taking advantage of its own failure to prepare, and to conform its investigation to, an "initial scope" that would define the investigation it was to conduct;
- d. Charging the City for unnecessary legal work—\$6.2 million in fees (the equivalent of a well-paid attorney working 8 hours a day, 5 days a week, 50 weeks a year for ten years)—which was performed only to generate fees for V&E, not for any benefit that it would confer on the City; and
- e. Knowingly exceeding the City Council serial appropriations, made for V&E "to complete the report," when V&E knew full well that it had the City over a barrel and could continue to bill the City for what, effectively was unnecessary work to "pad" Vinson & Elkins' fundamentally flawed effort.

C. PROFESSIONAL NEGLIGENCE

Third, Vinson & Elkins committed professional negligence. As its attorney, Vinson & Elkins owed the City a duty of care and skill in performing professional services on behalf of the City. Vinson & Elkins also had an obligation to comply with applicable professional standards. The conduct of Vinson & Elkins as described in this Report constituted a breach of its duty to exercise reasonable care and skill in performing accounting services for the City and as such, constitutes actionable professional negligence.

D. VIOLATIONS OF THE CALIFORNIA FALSE CLAIMS ACT

Finally, Vinson & Elkins violated the California False Claims Act (California Government Code §§ 125650-125656). The False Claims Act, under specified circumstances, imposes civil liability for the submission of a false claim for payment to the City. Sections 125651(a)(1) and (2) apply to Vinson & Elkins by prohibiting the knowing submission of a false claim for payment to the City and the knowing use of a false record to get a false claim paid by the City. The term “knowing,” as defined by statute, includes actual knowledge, deliberate disregard and reckless disregard of the truth or falsity of the information.

Vinson & Elkins violated the False Claims Act by knowingly padding its bills for services to the City for work that was unauthorized and unnecessary. Vinson & Elkins also violated the False Claims Act by knowingly charging the city hourly rates that were higher than “governmental discount rates,” while representing that such rates were in fact discounted. In so doing, V&E opened itself up to treble damages in addition to civil penalties of up to \$10,000 for each false claim.

V.

CONCLUSION

Based upon the facts and circumstances set forth in this report it is the San Diego City Attorney’s considered judgment that the City should take appropriate legal action to recover the considerable damages proximately caused by Vinson & Elkins’ breach of duties owed to the City of San Diego.

By _____
Michael J. Aguirre
City Attorney

Exhibit 28

Council asked for shield in settlement | City told its lawyers to negotiate with SEC

[1,2,6,7 Edition]

The San Diego Union - Tribune - San Diego, Calif.

Author: Jennifer Vigil

Date: Dec 15, 2005

Start Page: B.1.1.7

Section: LOCAL

Text Word Count: 1048

Document Text

Editions vary

The San Diego City Council authorized its legal team last year to negotiate with federal regulators examining the city's financial practices, but 11 months later council members balked at City Attorney Michael Aguirre's plan to try to reach a similar agreement.

Yesterday, Aguirre released the record of a Sept. 21, 2004, closed session that shows six council members, including former Mayor Dick Murphy, ordered the city's private attorneys "to negotiate with" the Securities and Exchange Commission for the best deal possible.

The instruction included a "caveat that (the) City Council be included" in such a deal, and it specifies that council members should "not be left to be dealt with separately."

In August, Aguirre also recommended settling with the SEC to conclude an investigation into whether investors were misled about San Diego's liabilities when the city issued more than \$1 billion in bonds.

The move could have left the city government subject to fines and ongoing oversight, among other penalties.

Aguirre wanted investigations of individuals' actions to proceed, a path he said the SEC has been open to in the past. That plan drew immediate fire from council members.

Councilwoman Toni Atkins said it amounted to a premature admission of guilt, while Councilman Scott Peters accused Aguirre of trying to usurp the council's policy-making power.

The possible securities violations came to light nearly two years ago when the city filed revised financial disclosures acknowledging errors and omissions in bond offerings dating to 1996.

Some of the changes were related to the city's ongoing pension crisis, which includes questions over increases in employee benefits granted twice in the past decade and the system's deficit of at least \$1.4 billion.

Aguirre said the one-page record of the closed session "indicates there has been an ongoing cover-up and ongoing manipulation" on the part of the City Council.

It is unclear whether federal investigators have the document, Aguirre said, but he has contacted them to turn it over. His office missed it in an initial review of closed-session records but discovered it during a subsequent examination last week, he said.

Peters said Aguirre is misinterpreting the council action, taken five days after the release of a law firm's independent investigation into the city's handling of its pension fund.

The city, with that report in hand, was confident that the law firm Vinson & Elkins, which also was representing San Diego before the SEC, could embark on successful negotiations with regulators.

"That was the intent," Peters said. "Now that we had the report finished, go to the SEC and see how quickly we can resolve this without spending a lot on legal fees."

That plan fell apart. Auditing firm KPMG, which has yet to sign off on the city's 2003 financial statements, said the law firm's report was insufficient, a development that forced the city's legal and auditing costs to climb exponentially. They

now exceed \$24 million.

Regardless, Peters said, Aguirre's August settlement proposal was improper.

"We didn't even see it before he proposed it," Peters said. "We believe any responsible attorney would discuss the terms of a settlement with the body that has to approve it before he releases it to the SEC and the press."

Of the six who voted in favor of striking a deal with the SEC in 2004, only Peters, Jim Madaffer and Brian Maienschein remain on the council. Two current council members, Atkins and Donna Frye, were not at the closed session.

Murphy resigned in July, followed by Ralph Inzunza and Michael Zucchet, who resigned after their federal corruption convictions. (Zucchet's convictions were reversed last month, though prosecutors have said they intend to appeal that decision.)

The District 4 seat was vacant at the time of the closed session, which occurred one month after the death of Councilman Charles Lewis. Tony Young was elected in January.

Madaffer's spokeswoman said "he's not commenting on anything" regarding an ongoing investigation. Maienschein and his chief of staff did not return calls.

Aguirre discussed the 15-month-old closed session in a news conference in which he touched on developments in a San Diego Superior Court hearing involving former pension board members and pledged to open an internal investigation into the actions of his office related to the pension crisis.

Aguirre, whose one-year tenure as city attorney has been marked by staff departures and strife, said "some people may think I went too far in terms of ridding this office of individuals. Now people may say I didn't go far enough."

"I cannot ignore the evidence that has come forward," he said. "We need to investigate the depth and involvement of these city attorneys."

The record of the closed session last year shows that staff members from the City Attorney's Office, including Les Girard, a former assistant city attorney, were in attendance.

Aguirre also released a memo by Girard that was mentioned at the court hearing, in which six former pension board members are facing charges stemming from their 2002 votes in favor of a plan to underfund the retirement system.

One aspect of the pension case covers a benefit offered to city employees who serve as union presidents.

The Girard memo, dated Aug. 3, 2004, offered Rich Snapper, the city's personnel director, proof that he had been granted indemnity, or freedom from personal legal liability, should the city be taken to court over the benefit for labor leaders.

The City Council unanimously approved the legal protection for Snapper and City Auditor Ed Ryan in a May 2002 closed session. Girard also sent a letter to Ryan's attorney confirming the indemnification.

Girard wrote the memo and the letter after Ryan retired; the auditor left the city days before the amended bond disclosures were filed in January 2004. Soon after, the SEC and the U.S. Attorney's Office confirmed they had launched investigations into the city's financial practices.

Pension board members, including those charged in the criminal case, also sought and received legal protection from fallout related to the underfunding plan.

Ryan and several other city officials have refused to testify at the hearing, citing their rights against self-incrimination. At the conclusion of the proceeding, which could continue through next month, the judge will decide if the evidence warrants ordering the defendants to stand trial.

Jennifer Vigil: (619) 718-5069; jennifer.vigil@uniontrib.com

Credit: STAFF WRITER

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

Abstract (Document Summary)

Councilwoman Toni Atkins said it amounted to a premature admission of guilt, while Councilman Scott Peters accused [Michael Aguirre] of trying to usurp the council's policy-making power.

Of the six who voted in favor of striking a deal with the SEC in 2004, only Peters, Jim Madaffer and Brian Maienschein remain on the council. Two current council members, Atkins and Donna Frye, were not at the closed session.

Aguirre also released a memo by [Les Girard] that was mentioned at the court hearing, in which six former pension board members are facing charges stemming from their 2002 votes in favor of a plan to underfund the retirement system.

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

GOVERNMENT

[Close Window](#)

[Print Page](#)

Council Tried to Settle with SEC in 2004

By ANDREW DONOHUE

Wednesday, December 14, 2005 | The City Council directed its attorneys to negotiate a settlement for themselves and the city with the Securities and Exchange Commission during a closed hearing in September 2004.

City Attorney Mike Aguirre and outside attorneys have been negotiating with the SEC over possible securities fraud violations since October of this year. The negotiations only deal with the city and do not include any City Council members or other individual city officials. Some council members originally objected to the idea of the city settling with the SEC when Aguirre first suggested it in August.

But on Sept. 21, 2004, the City Council voted 6-0 to authorize a team to negotiate with the SEC "for best deal possible, with caveat that City Council be included in deal with City and not be left to deal with separately," according to a report on the closed session meeting obtained by the *Voice of San Diego*.

Councilwomen Toni Atkins and Donna Frye were absent from the meeting. Councilmen Scott Peters, Michael Zucchet, Brian Maienschein, Jim Madaffer and Ralph Inzunza, and former Mayor Dick Murphy voted in favor of the resolution.

Murphy, Zucchet and Inzunza have all since resigned. Current City Councilman Tony Young was not on the council at the time -- his District 4 seat was vacant.

The negotiations were sparked by the release of a city-sanctioned investigative report by law firm Vinson & Elkins days earlier. The report stated that the city's financial disclosure process was woefully inadequate, but it didn't place individual blame for the errors and omissions in the city's annual financial disclosures to investors and the general public.

The report was eventually rejected by the SEC for its lack of independence and decried by detractors as a whitewash. The firm was criticized for serving as both an investigator and a defense attorney for the city.

"What this shows is that there was plenty of interest in settling with the SEC when it was to the individual advantage of the council members," Aguirre said.

The city attorney has in essence left the City Council and other city officials to fend for themselves in the SEC's investigation into possible securities fraud. He has sought to sever individuals from the city and negotiate a deal to end the investigation of the city as an entity by admitting that it offered material misstatements and omissions in its financial statements.

The City Council authorized Aguirre to proceed with the negotiations in September of this year, although a few did so begrudgingly.

Nothing came of the council's negotiations with the SEC. Peters said he didn't remember what happened with the council's desire to settle in 2004. However, he said he is wary of settlement

talks this time around because the city attorney is conflicted because he has opined that some members of the City Council committed securities fraud.

"The SEC has told us they don't think Mike Aguirre is independent," Peters said.

He said the council fully supports a settlement.

"The City Council's always wanted to settle with the SEC. If you've heard otherwise, it hasn't been from the City Council. We would love to get the investigations behind us," Peters said.

Frye said she didn't know her colleagues had authorized negotiations in 2004.

She said she didn't attend the hearing because she didn't feel comfortable going into closed session meetings on anything related to Vinson & Elkins. Closed session document shows that its two lead attorneys were present at the time of the City Council's September 2004 vote.

"They were supposed to be preparing an independent report and fully cooperating and disclosing everything, so it seemed odd that we would be meeting in closed session at the same time we were supposed to be open," Frye said.

Vinson & Elkins eventually left San Diego in August after completing two investigations that were rejected by the SEC and the city's outside auditor, KPMG, for their lack of independence.

The firm has billed \$7 million for its work, which began in February 2004. Without the completion of an independent investigation, the city's credit rating, access to Wall Street, and fiscal year 2003 audit remain on hold.

The SEC often uses an entity's level of cooperation as one factor in determining its fines. The completion of an independent investigation is an important measure of cooperation.

The city brought in an audit committee headed by former SEC Chairman Arthur Levitt to reconcile investigations conducted by Vinson & Elkins and Aguirre. The audit committee's investigation has also been beset by delays and budget problems.

Audit committee officials estimate their investigation will now stretch into May and cost an additional \$9 million to \$11 million to complete. To date, they have billed the city at least \$6 million.

The U.S. attorney and SEC have been investigating city finances and politics since February 2004.

Please contact Andrew Donohue directly at

Close Window

Exhibit 29



MICHAEL J. AGUIRRE
SAN DIEGO CITY ATTORNEY

Copy

Hand Delivered

December 15, 2004

Lawrence Grissom
Retirement Administrator
San Diego City Employees Retirement System
401 B Street, Suite 400
San Diego, CA 92101

RE: City Attorney As Legal Advisory to Board of Administration
Per City of San Diego City Charter Section 40

Dear Mr. Grissom:

Effective immediately the undersigned assumes the role of chief legal advisor to the Board of Administration of the Retirement System.

All counsel currently serving the board in a legal advisory capacity are immediately discharged from those duties, and directed to contact Richel Thaler in the office of the City Attorney for further information and/or assignment. All personnel identifications and office access devices are to be turned in to you immediately. All files and office materials, including computers, are to remain in the respective offices of these former counsels, and not removed or altered in any way unless and until you receive specific directions from me in that regard.

Background:

The City Employees' Retirement System (sdCERS) is governed by Article IX, Sections 141 through 148.1 of the City of San Diego City Charter, other relevant Charter provisions and all applicable laws of the State of California. Originally established in 1927, the City created the fund without a separate trust agreement. The City Treasury holds the monies of sdCERS.

City of San Diego City Charter Section 40 provides, in part, for the office of the City Attorney, as follows:

"The City Attorneys shall be the chief legal advisor of, and attorney for the City and all Departments and offices thereof in matters relating to their official powers and duties. . . .

It shall be the City Attorney's duty, either personally or by such assistants as he or she may designate, to perform all services incident to the legal department; . . ."

In recognition of this Charter mandate, San Diego Municipal Code Sec. 24.0910 provides that, "...the City Attorney shall designate one of his staff to advise and represent the Board of Administration in the administration of the retirement system."

City of San Diego City Charter Section 40 further provides, in part, as follows:

"The City Attorney shall have charge and custody of all legal papers, books and dockets belonging to the City pertaining to his office..."

Prior to 1998, the office of the City Attorney provided legal services to the Board by assigning deputy City Attorneys to give day-to-day legal advice on a variety of issues. By 1998, sdCERS sought to replace the City Attorney with a "General Counsel" to the Board of Administration, separate from the control and oversight of the City Attorney. Notwithstanding the clear conflict with the Charter, and the possibility for behavior inconsistent with the interests of the people of the City of San Diego, it argued its rights to do so under California Constitution Article XVI, section 17 (Proposition 162), which was read by sdCERS to grant to it plenary (argued to mean exclusive and unfettered) authority over the System.

The City Attorney did not concur with the Board's analysis of the applicable law, but capitulated to the Board's demand. On November 10, 1998, an ordinance was passed which: 1) specifically reflected the position of the Board demanding the right to appoint its own separate General Counsel and achieve the repeal of Municipal Code Sec. 24.0910; 2) specifically reflected the objection of the City Attorney to the Board's desire to repeal the Municipal Code provisions for City Attorney's participation as mandated by the Charter; and 3) resolved the matter by providing for the option of a General Counsel position to the sdCERS Board under a Memorandum of Understanding between the City Attorney and the Board. Municipal Code Sec. 24.0910 was adopted specifically retaining the City Attorney's Charter rights as legal counsel to the Board but also providing for the alternate General Counsel(s) under a Memorandum of Understanding.

On or about July 22, 1998, the City Attorney and the Board executed a Memorandum of Understanding allowing the Board to retain its own legal services department; however, that same MOU specifically reserved the City Attorney's rights under the Charter and Municipal Code "regarding his rights and responsibilities to the Retirement System under Section 40 of the City Charter."

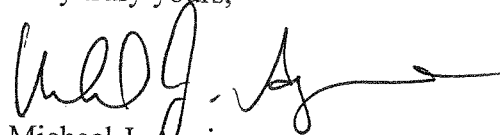
There was no term to the Memorandum of Understanding agreement.

The undersigned City Attorney discontinues any effect of the above-mentioned MOU and assumes the role of chief legal advisor to the Board of Administration of the Retirement System effective immediately, on the following grounds, among others:

1. The decision of the prior City Attorney to abdicate his role under the Charter and the relevant Municipal Codes was legal error. Municipal Codes and Memorandums of Understanding do not allow for the abdication of the City Attorney's right to serve or responsibility to serve, in the role of legal advisor to the Board of Administration.
2. In the absence of a term in the 1998 MOU between the City Attorney and the Board, the term is confined to that of the last City Attorney and the undersigned declares the term to have expired.
3. The law of the State of California regarding the extent of the powers of a Retirement Board Under California Constitution Article XVI, section 17 (Proposition 162) has since been clarified in *Westly v. CALPERS*, 130 Cal. Rptr. 2d 149 (Calif App. 2003), (Appealed to the California Supreme Court 3/11/03; Review denied and request to depublish, Denied 2003 Cal. LEXIS 2690). That opinion confirms that such Boards only have very limited plenary powers over matters essential to the administration of the retirement system. The opinion dramatically limits the asserted expanded powers of such boards, especially in the face of regulatory and administrative efforts of municipal plan sponsors and contributors. Specifically, the Board does not have the authority to engage in administrative actions that conflict with other applicable legal authority. In that regard, Municipal Code Section 24.0910 does not deprive, or limit, the City Attorney from acting as the chief legal advisor to the Board under City of San Diego City Charter Section 40, and the undersigned asserts his right to so serve.

Thank you for immediately effectuating the directions in this letter.

Very truly yours,



Michael J. Aguirre
San Diego City Attorney

cc: Fredrick W. Pierce
Loraine Chapin, Esquire

Aguirre asserts control of pension legal affairs

[1,2,6,7 Edition]

The San Diego Union - Tribune - San Diego, Calif.

Author: Philip J. LaVelle

Date: Dec 17, 2004

Section: NEWS

Document Types: QUOTE

Text Word Count: 1269

Document Text

Calling San Diego's pension system "out of control," City Attorney Mike Aguirre announced yesterday that he is assuming the role of chief legal adviser to the troubled retirement system and demanding that sensitive documents be placed in his custody.

Aguirre's move -- announced just 10 days after he took office -- drew immediate resistance from retirement officials, praise from some quarters and silence from Mayor Dick Murphy.

For the past six years, the San Diego City Employees Retirement System has had its own in-house legal staff. Previously it was represented and advised by the City Attorney's Office.

Aguirre told a news conference that the use of in-house staff has been "an experiment that hasn't worked."

He said subpar legal advice had contributed to the system's many deep problems, including a \$1.2 billion deficit, federal criminal investigations and untold millions paid in legal fees to top-dollar private law firms.

"I think I can do a better job in representing the interests of the people of San Diego," Aguirre said.

On Wednesday, Aguirre informed retirement system administrator Larry Grissom in a letter that he was asserting his rights as chief legal officer of the system. Aguirre cited the city charter as the document empowering the move.

Aguirre also directed Grissom to secure all legal files and office equipment, including computers, with the specific instruction that they not be "removed or altered in any way unless and until you receive specific directions from me ... "

He also told Grissom to send the system's three-person legal staff to the City Attorney's Office "for further information and/or assignment" and to collect their keys and identification badges.

"I have not done any of that," Grissom said yesterday. "I will not do any of that."

Yesterday, retirement board President Frederick W. Pierce IV told Aguirre in a letter that his demand "exceeds your powers under the City Charter." Copies went to Murphy and the City Council.

"My letter really speaks for itself," Pierce said yesterday. "We disagree with the city attorney's opinion and interpretation of (legal) authorities. The retirement system is an independent entity, and we have the authority to hire our own general counsel and legal advisers."

Aguirre said resistance would be illegal.

"Mr. Grissom and members of the board of the pension plan that defy this mandate of the charter will be held fully responsible under the law for their behavior," he said in an interview.

Aguirre declined to say what actions he might take.

Murphy did not return a phone call seeking comment. His press secretary said he was likely not to comment.

Aguirre's move comes at a time of great unrest at City Hall, much of it driven by the pension crisis, as well as a disputed mayoral election.

The city this year entered into a settlement with retirees who alleged a 2002 underfunding arrangement was illegal. The

agreement will increase the city's contributions to the pension system by hundreds of millions of dollars.

Also this year, the city's credit ratings were downgraded several times, and investigations were launched by the FBI, the Securities and Exchange Commission and the U.S. attorney after city officials were forced to reveal errors and omissions in financial documents used by bond investors.

Among the omissions: The full scope of the city's pension underfunding and the threat it poses to vital city services.

Deep cuts and fee hikes are expected in the next budget.

The city also has failed to release its 2003 and 2004 audits. This prompted Standard & Poor's Ratings Services to suspend San Diego's credit rating in September. The city is unable to issue bonds for important projects, including sewer upgrades.

Murphy has said he is working hard to complete the audit.

Aguirre is playing a key role in that process, and launched his own investigation to dig up information for the city's outside auditor, financial-services giant KPMG. In October, KPMG warned that City Hall had failed to explore "likely illegal activity."

If Aguirre succeeds in becoming the pension system's lawyer, he would have access to a potential treasure trove of legal documents prepared over the years, which may contain information important to KPMG.

Aguirre did not specifically confirm that gaining access to these records is his strategic aim.

But he did say: "I think that there's no question that we need the cooperation and access to the documents in the pension plan to understand if there are other outstanding issues. I think there is a true lack of trust and a concern about whether we can rely upon the information that's being provided, and the best way, the most direct, is to gain access to those records."

Aguirre's move was hailed by April Boling, who chaired the city's Pension Reform Committee. Boling is president of the San Diego County Taxpayers Association and serves as campaign treasurer to several local politicians, including Murphy.

"I believe Aguirre is doing everything in his power to provide the information that KPMG needs in order to complete the audit," she said. "If he believes that this is a necessary step in accomplishing that, then I think he should take it."

Boling also blasted a plan, revealed in The San Diego Union-Tribune yesterday, to put pension board whistle-blower Diann Shipione under citizen's arrest and turn her over to police at a Nov. 19 closed session board meeting.

Shipione's warnings in recent years brought the pension system's problems to light, to the consternation of many other city officials.

Grissom said the plan to involve police was his idea, and involved board president Pierce and board member Charles Hogquist, a San Diego Police Department lieutenant who arranged to have officers on standby downtown.

"I just find that wholly inappropriate," Boling said. "I can't even think what the right word is to describe it. I was appalled."

Shipione did not attend the closed session and the plan never went into effect. That day, the board voted to ban her from future closed sessions for allegedly leaking confidential information about legal fees to a retiree. Shipione says she only gave out vague, unprivileged information and did nothing wrong.

The board also voted to file a complaint against Shipione with the city Ethics Commission and to ask Murphy to remove her from the board.

Boling said Proposition H, a ballot measure approved last month that calls for a newly constituted retirement board by April, should be implemented immediately. She has also put the board on notice she may sue to roll back benefits granted in 2002. She alleges conflicts of interest by several board members -- city employees and union representatives -- who benefited in the deal.

Councilwoman Donna Frye, chairwoman of the City Council's new Open Government Committee, sent memos yesterday to Police Chief William Lansdowne and Pierce seeking information about the plan to take Shipione into custody.

Aguirre also opened an investigation into whether the board violated California's open-meeting law on Nov. 19.

Shipione's husband, lawyer Pat Shea, is an unpaid informal adviser to Aguirre. Aguirre said the association had nothing to do with his actions.

"Pat Shea and Diann Shipione have done an excellent job, and had the board been more carefully observant of Ms. Shipione's remarks and concerns, we wouldn't be facing the financial crisis that we are today," he said.

Philip J. LaVelle: phil.lavelle@uniontrib.com

[Illustration]

2 PICS; Caption: 1. City Attorney Mike Aguirre said yesterday he plans to play an active role in pension system. 2. City Attorney Mike Aguirre said yesterday that using in-house legal staff by the city's retirement system has been "an experiment that hasn't worked."; Credit: 1,2. Don Kohlbauer / Union-Tribune

Credit: STAFF WRITER

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

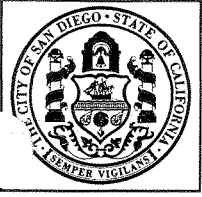
Abstract (Document Summary)

On Wednesday, [Mike Aguirre] informed retirement system administrator Larry Grissom in a letter that he was asserting his rights as chief legal officer of the system. Aguirre cited the city charter as the document empowering the move.

[Diann Shipione]'s husband, lawyer Pat Shea, is an unpaid informal adviser to Aguirre. Aguirre said the association had nothing to do with his actions.

2 PICS; 1. City Attorney Mike Aguirre said yesterday he plans to play an active role in pension system. 2. City Attorney Mike Aguirre said yesterday that using in-house legal staff by the city's retirement system has been "an experiment that hasn't worked."; Credit: 1,2. Don Kohlbauer / Union-Tribune

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.



San Diego City Attorney **MICHAEL J. AGUIRRE**

NEWS RELEASE

FOR IMMEDIATE RELEASE: January 12, 2005

Contact: Maria Velasquez, Communications Director: (619) 235-5725 (pager & voicemail) mvelasquez@saniego.gov

CITY ATTORNEY REASSERTS ROLE AS CHIEF LEGAL ADVISOR TO EMPLOYEES' RETIREMENT SYSTEM AMIDST ALLEGATIONS OF IRS VIOLATIONS

City Attorney Michael Aguirre today reasserted the San Diego City Attorney's authority, under Section 40 of the San Diego City Charter, to assume the role of chief legal advisor to the San Diego City Employees' Retirement System (SDCERS). His directive was issued on December 9, 2004.

"The pension plan manager and attorneys have adopted a policy of stonewalling and delaying," said City Attorney Aguirre. "Each day that passes will result in appropriate sanctions." The City Attorney further stated, "the question is not if, but when the authority of the City Attorney will be fully recognized and implemented."

The City Attorney released the statement after receiving numerous calls from the news media regarding his reaction to the October 29, 2004 Presidential Retirement Benefits memorandum from Retirement Administrator Lawrence Grissom to City Manager Lamont Ewell.

The memo informs the City Manager that the Retirement Board's outside tax counsel advised SDCERS to refund all contributions related to respective union presidents who were receiving presidential benefits "because a union does not meet the tests specified by various Federal agencies as a governmental employer." The memo further states, "it is their advice that not to do so, to continue to accept contributions from that source, or to pay benefits based upon contributions thus received, would endanger the tax qualified status of the [retirement] plan."

The City Attorney believes the memorandum demonstrates that present legal counsel to SDCERS has proven to be inadequate. "Outside counsel gave proper legal advice that the presidential retirement benefits plan violated IRS law," said City Attorney Aguirre. "This advice should have been provided by SDCERS legal counsel on day one when the union presidential retirement benefits plan was initially discussed in 2002."

###

**Office of
The City Attorney
City of San Diego**

MEMORANDUM

Date: 22 February 2005
To: Honorable Mayor and Members of the City Council
From: San Diego City Attorney Michael J. Aguirre
Subject: Legal Action Plan To Address City's Financial Condition

I.

BACKGROUND

The City of San Diego (City) lost its credit rating in 2004 and therefore is unable to sell municipal bonds in the public market.¹ On 20 September 2004, citing the delayed release of the City's fiscal 2003 audit, Standard & Poor's suspended the City's credit rating:

The ratings are suspended due to the continued absence and lack of estimated release date for the city's fiscal 2003 audited financial statements. The delay in release of the city's audited financial statements for fiscal 2003, which ended nearly 15 months ago, creates uncertainty regarding the city's true financial condition with an unknown effect on credit quality.²

On 16 February 2005, Fitch Ratings downgraded its rating of City bonds. Fitch took this action against San Diego "as a result of continued delays in the

¹ See, City of San Diego Municipal Secondary Market Disclosure notification that "On September 20, 2004, Standard & Poor's Ratings Services announced that it had suspended its ratings and underlying ratings (SPURs) on the City of San Diego, California's general obligation bonds, general fund-backed lease notes, including those issued by all City entities (except Housing Authority and Area Housing and Finance Agency)."

² See, 20 September 2004 Standard & Poor's news release "San Diego, CA's Ratings Suspended Due to Continued Delay in Release of Fiscal 2003 Audit" attached to the City of San Diego Municipal Secondary Market Disclosure notification of 20 September 2004.

release of the city's fiscal 2003 audited financial statements.”³ Explaining its decision, Fitch emphasized the City's failure of “effective management.”

Today's downgrade reflects Fitch's emphasis on effective management as a key component of credit quality. Fitch believes that San Diego's political and management deficiencies can be remedied, although effective change will require strong commitment to reform prior practices and coordinate decisive actions taken by the mayor, city council, city manager, SDCERS board, labor groups, and other interested and responsible parties. Evidence of significant structural change and a resulting positive effect are crucial to Fitch's returning San Diego's ratings to higher levels. In fact, Fitch believes the city has the potential to return to a position of above-average credit quality based on its economic strength and ability to translate positive economic performance into sound financial operations through its varied tax structure.

However, further evidence of a widespread and united commitment to restore financial stability is needed to achieve higher ratings.

Fitch continues to await release of the city's audited financial reports for fiscal years 2003 and 2004, along with further evidence of significant structural reform.⁴

The City of San Diego, having withdrawn its last public bond offering on 9 September 2003,⁵ has not gone to the public bond market for 17 months.⁶ The last

³ See, 16 February 2005 Fitch Ratings news release “Fitch Lowers San Diego, California's \$2.17B Debt; Watch Negative” attached to the City of San Diego Municipal Secondary Market Disclosure notification of 18 February 2005.

⁴ 16 February 2005 Fitch Ratings news release.

⁵ 16 September 2004 Report by the City of San Diego's outside counsel Vinson & Elkins (“16 September 2004 Report”).

⁶ 16 September 2004 Report p. 111.

certified financial statement for the City issued free of known material errors was for fiscal 2001.

II.

CITY ATTORNEY PROPOSAL: AN EFFECTIVE LEGAL ACTION PLAN

The San Diego City Attorney is proposing an eight-step legal action plan both to facilitate the issuance of the City's 2003 certified financial statement and to assist the City's reentry into the municipal bond markets. The first step in the proposal is a request that the Mayor and Council accept the findings of the City Attorney's Interim Reports One and Two, without prejudice to admitting or denying those findings in their personal capacity.

RECOMMENDATION NO 1: THAT THE MAYOR AND CITY COUNCIL CONDITIONALLY ACCEPT ON BEHALF OF THE CITY OF SAN DIEGO THE MATERIALS AND FINDINGS CONTAINED IN SAN DIEGO CITY ATTORNEY'S FIRST AND SECOND INTERIM REPORTS.

On 11 October 2004, following the release of the 16 September 2004 report prepared by the City's outside counsel, Vinson & Elkins (V&E), the City's outside auditor, KPMG, notified the City of the need for an independent investigation into possible illegal acts by City personnel:

As shared in previous meetings and correspondence, including our letters dated August 9, 2004 and September 1, 2004, we do not believe that the City of San Diego . . . has conducted an adequate investigation in order to conclude that likely illegal acts have not occurred, or that appropriate remedial action has been taken. Such an investigation is necessary in order for an auditor to complete an audit in accordance with generally accepted auditing standards and Government Auditing Standards.⁷

In its 11 October 2004 letter to the City, KPMG raised specific concerns about the lack of adequate support for V&E's conclusion that no evidence existed

⁷ 11 October 2004 KPMG letter to the City of San Diego.

that City officials acted intentionally in connection with alleged illegal acts involving the City's pension plan:

The V&E report includes two paragraphs under a heading "Conclusions Regarding Intent." These paragraphs state that because many of the "gaps" in the City's disclosures are "closed" when information in the SDCERS CAFRs [Comprehensive Annual Financial Report] is considered and because local press coverage of the pension plan highlighted many of the risks surrounding the more controversial City funding agreements (Managers I and II) and the presence in the Municipal Code of the menu for distribution of surplus earnings, any attempt to conceal the SDCERS funding situation would have been an "exercise in futility."⁸

KPMG found that this V&E conclusion did "not address the questions we have posed as being important to our completion of our audit, and therefore, does not end our inquiry."⁹ As KPMG noted at a 27 August 2004 meeting with the City and V&E representatives, "[b]oth the City and V&E have made it clear to KPMG that V&E was not retained to investigate issues relating to intent or whether any individual's conduct violated any law, rule or regulation, and that the scope of its investigative efforts were not designed to do so."¹⁰

Further, KPMG found insufficient evidence to support exculpatory statements made by V&E in favor of City officials:

Unfortunately, based upon the information we have been provided to date regarding the scope and method of the V&E investigation, we do not believe the statement in the report that "it is difficult to attribute the City's failure to fully and accurately describe [pension] matter[s] to intentional misconduct on the part of individual employees" is sufficient to resolve the issue of potential illegal acts for purposes of KPMG's audit because it is not based on an investigation that had a

⁸ 11 October 2004 KPMG letter to the City of San Diego.

⁹ 11 October 2004 KPMG letter to the City of San Diego.

¹⁰ 11 October 2004 KPMG letter to the City of San Diego.

scope and methodology that would provide a reliable basis for reaching a conclusion as to whether City officials engaged in intentional misconduct or other conduct, which violated any law, rule or regulation having the force of law.¹¹

On 29 October 2004, KPMG reiterated its position not only that a more thorough investigation of alleged illegal acts by City officials was needed but also that it would not issue its audit opinion until such an investigation was complete:

First, KPMG cannot, and will not, complete an audit of the 2003 financial statements unless the City completes an independent investigation of potential illegal acts as we have outlined in our prior correspondence.¹² [Emphasis added.]

KPMG also explained that the investigation was needed to provide “clear legal conclusions” to questions about whether City officials engaged in illegal acts and if so, whether such conduct should be disclosed on the City’s 2003 financial statement and whether the City had taken appropriate remedial action:

The City, as the issuer of its financial statements, must conclude on the question of whether any of the issues discussed in our October 11, 2004 letter and its attachments and the conduct discussed in the V&E report was illegal and, if so, whether any violations must be disclosed, and have been adequately disclosed, in the financial statements in accordance with GAAP. We would further expect the City would also determine to its satisfaction that all necessary and appropriate remedial actions have been taken with respect to conduct that is investigated.

It is because it is the City's obligation to reach these conclusions that KPMG has suggested that the City obtain from its investigators sufficiently clear legal conclusions to enable the City to make the necessary determinations....¹³ [Emphasis added.]

¹¹ 11 October 2004 KPMG letter to the City of San Diego.

¹² 29 October 2004 KPMG letter to the City of San Diego.

¹³ 29 October 2004 KPMG letter to the City of San Diego.

KPMG asked the City to consider retaining Counsel other than V&E to conduct the additional investigation.¹⁴ KPMG was concerned about whether Vinson & Elkins could be objective in light of the fact that the firm was already defending the City in the related Securities & Exchange Commission (SEC) investigation.

The positions asserted in, and oppositional tone of, Mr. Maco's letter raises questions about V&E's willingness or ability in these circumstances to complete the investigation of, and reach conclusions on, the audit-critical questions posed in our prior oral and written communications and to do so in an objective and independent manner. Our reading of the letter suggests to us that, at this point, conducting the kind of investigation that is necessary may be in tension with V&E's ongoing representation of the City in the pending SEC investigation.¹⁵ [Emphasis added.]

In its 29 October 2004 letter, KPMG included references to the applicable audit procedures related to illegal acts. First, KPMG noted the City's obligation to comply with "Generally Accepted Accounting Principles (GAAP) applicable to governments."¹⁶ Second, KPMG enclosed "a copy of a very recent Practice Alert published by the American Institute of Certified Public Accountants on 'Illegal Acts.'"¹⁷ The "Practice Alert" refers expressly to AU § 317.02, which defines illegal acts for auditing purposes to include "violations of laws or governmental regulations."

Definition of Illegal Acts

.02 The term *illegal acts*, for purposes of this section, refers to violations of laws or governmental regulations. Illegal acts by clients are acts attributable to the entity whose financial statements are under audit or acts by

¹⁴ "If the City is prepared to proceed with an appropriate investigation, then we urge you to consider retaining counsel other than V&E to do so." 29 October 2004 KPMG letter to the City of San Diego.

¹⁵ 29 October 2004 KPMG letter to the City of San Diego.

¹⁶ 29 October 2004 KPMG letter to the City of San Diego.

¹⁷ 29 October 2004 KPMG letter to the City of San Diego.

management or employees acting on behalf of the entity. Illegal acts by clients do not include personal misconduct by the entity's personnel unrelated to their business activities.¹⁸ [Emphasis added.]

Whether illegal acts have occurred is uniquely a question for a legal expert, and AU § 317.03 so provides:

Dependence on Legal Judgment

.03 Whether an act is, in fact, illegal is a determination that is normally beyond the auditor's professional competence. An auditor, in reporting on financial statements, presents himself as one who is proficient in accounting and auditing. The auditor's training, experience, and understanding of the client and its industry may provide a basis for recognition that some client acts coming to his attention may be illegal. However, the determination as to whether a particular act is illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law.¹⁹ [Emphasis added.]

Thus, KPMG's request for a determination of whether illegal acts have occurred is clearly contemplated by § 317.03. As suggested by the SEC and U.S. Grand Jury investigations of the City, once KPMG determined the existence of "possible illegal acts," it was correct in seeking guidance from the City's attorney, Vinson & Elkins.

Audit Procedures in Response to Possible Illegal Acts

.10 When the auditor becomes aware of information concerning a possible illegal act, the auditor should obtain an understanding of the nature of the act, the circumstances in which it occurred, and sufficient other information to evaluate the effect on the financial statements. In doing so, the auditor should inquire of management at a level above those involved, if possible. If management does not provide satisfactory information that there has been no illegal act, the auditor should—

¹⁸ AU § 317.02.

¹⁹ Identification of an "illegal act" does not carry with it a conclusion that the act was criminal in nature. An act may be in violation of law or a governmental regulation but not constitute a "crime." AU § 317.03.

a. Consult with the client's legal counsel or other specialists about the application of relevant laws and regulations to the circumstances and the possible effects on the financial statements. Arrangements for such consultation with client's legal counsel should be made by the client. [Emphasis added.]

b. Apply additional procedures, if necessary, to obtain further understanding of the nature of the acts.

On 2 November 2004, four days after KPMG wrote its 29 October 2004 letter suggesting that the City retain other legal counsel to conduct the illegal acts investigation, San Diego voters elected the current City Attorney.²⁰ A federal securities law trial attorney for 25 years, the City Attorney is both a Certified Fraud Examiner and a Certified Fraud Specialist. The San Diego City Charter § 40 provides in pertinent part that the City Attorney is "to perform all services incident to the legal department."²¹

After the City Attorney discovered KPMG's October 29 letter, he attended two meetings with KPMG representatives, Mayor Dick Murphy, Councilmember Toni Atkins, City Manager Lamont Ewell, and others, during which KPMG expressed its view that the City Attorney was independent, and also expressed its preference that the City Attorney conduct the illegal acts investigation in cooperation with V&E. (Councilmember Donna Frye attended the first of the two meetings, which took place on 10 December 2004 and 17 December 2004.)

The City Attorney, who chose to accede to this preference, has issued two Interim Reports, the first on 14 January 2005, and the second on 9 February 2005. The interim reports reached the following conclusions:

INTERIM REPORT NO. 1 CONCLUSION:

Despite the substantial financial crisis faced by the City due to funding problems in the City pension plan, the Mayor's Blue Ribbon Committee Report on City of San Diego Finances represented the funding ratio as being 97%. Thus, the Mayor's Blue Ribbon

²⁰ See, San Diego City Council Resolution No. R-299922 adopted on 1 December 2004.

²¹ San Diego City Charter § 40.

Committee Report on City of San Diego Finances contained a material false statement that the San Diego City Pension Plan's funding ratio was 97% when in fact it was 89.9% funded as of 30 June 2001. The report also failed to disclose that by 11 October 2001 the audit staff of the City had determined that the investment portfolio of the City's pension plan had dropped significantly.

Finally, the possible triggering of the City's duty to make a sizeable balloon payment to the plan was not mentioned. City officials allowed this misinformation to be perpetuated despite various opportunities to correct the record. Thus, taxpayers and other users of the Mayor's Blue Ribbon Committee Report on City of San Diego Finances were misinformed about material financial information regarding the City finances. The failure to include accurate information about the dire financial condition of the City's employee pension plan in the Mayor's Blue Ribbon Committee Report on City of San Diego Finances used in February 2002 raises serious questions of misconduct by City officials.

INTERIM REPORT NO. 2 CONCLUSION:

[T]he San Diego City Attorney finds there is substantial evidence consistent with a finding that pension board members failed to hold the funds and assets of the City pension fund for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries in violation of California State Constitution Article 16, §17(a). These actions were not consistent with the duties imposed upon the City by the 23 July 1996 agreement. The City failed to live up to its commitment to keep the funded ratio at 82.3% and pension board members joined in that failure.¹³⁷ With the City failing to contribute the funds needed to keep the pension plan funding ratio at 82.3% it plunged to 65% as of 2004. As outlined, the Board was under a constitutional mandate to place the needs of the retirement fund's participants and their beneficiaries above all other duties, and thus ensure the financial integrity of the assets in its care. *Corcoran v. Contra Costa County Employees Retirement Board*, 60 Cal.App.4th 89, 94 (1997). By choosing to allow the plan's funding ratio to fall below the floor agreed to in Manager's Proposal I, the Board breached

its fiduciary duty to the City and the plan participants to protect the fund's assets.²²

Based upon these premises, the San Diego City Attorney concludes that there is substantial evidence consistent with a finding that the Mayor and Council authorized the issuance of City bond offering and related disclosure documents, identified above, that the Mayor and City Council Members knew to be false, as set forth above. Moreover, the San Diego City Attorney concludes that there is substantial evidence consistent with a finding that the Mayor and Council authorized bond offering documents and related disclosure offering documents, for the bond offerings identified above, while they recklessly disregarded facts indicating a risk that the disclosures might be misleading, as set forth above.

The San Diego City Attorney further concludes that there is substantial evidence consistent with a finding that the Mayor and Council had knowledge of facts set forth herein that brought into question the City's ability to repay the bonds sold by the City of San Diego, identified above. The City Attorney of San Diego finds that under these circumstances there is substantial evidence supporting a finding that it was reckless for the Mayor and City Council, with regard to the bond offerings identified above, to approve the related disclosures to investors without taking steps to prevent the dissemination of materially false or misleading information regarding those bonds. In this matter, such steps should have included becoming familiar with the disclosure documents and questioning the City's officials, employees, or other agents about the disclosure of the material facts.

Upon these premises the San Diego City Attorney concludes that there is substantial evidence consistent with a finding that the Mayor and City Council engaged in civil violations of federal securities laws. There is no finding of any wrongdoing by Council Member Tony Young.

²² Second Interim Report pp. 98-99.

There is no finding of any wrongdoing by Council Member Michael Zucchet. He did not take office until 2 December 2002.

KPMG has cited to the conclusion reached in the 16 September 2004 report of the City's outside counsel that any attempt to conceal the SDCERS funding situation would have been an "exercise in futility." The San Diego City Attorney concludes in this Second Interim Report that there is substantial evidence consistent with a finding that the Mayor and City Council did attempt to conceal and did conceal the granting of pension benefits in exchange for the waiver of the trigger and balloon payments.

The City Attorney of San Diego further concludes that there is substantial evidence consistent with a finding that the Mayor and City Council concealed the other aspects of the underfunding, trigger, balloon payments, wrongful accounting and funding practices as set forth in this report. Finally, the San Diego City Attorney concludes that there is substantial evidence consistent with a finding that the Mayor and City Council engaged in the alleged wrongful conduct either knowingly or recklessly.

The San Diego City Attorney has investigated the issues raised by KPMG in their correspondence of 11 October 2004 and 29 October 2004 and related writings. This investigation has been conducted to resolve the federal securities law issues raised in those writings. Additional City Attorney reports will address other possible illegal acts and other responsible parties, if and when requested by KPMG.

Finally, it should be stressed that much of the evidence set forth in this report was made available to the investigation only because the Mayor and Council made the honorable decision to waive the confidentiality privileges held by the City. They did this knowing that it would put them at risk.

The City Attorney respectfully requests that the San Diego City Mayor and Council receive and consent to the findings of the First and Second Interim Reports, but *without personal prejudice* to the Mayor or Council Members to admit or deny those findings in their personal capacity. Such action on the part of the Mayor and Council will resolve the securities issues raised by KPMG and enable

KPMG to assess the financial statement and internal control implications of such findings.

RECOMMENDATION NO. 2: THAT THE MAYOR, COUNCIL, AND OUTSIDE COUNSEL VINSON & ELKINS AUTHORIZE THE SAN DIEGO CITY ATTORNEY TO ENGAGE IN NEGOTIATIONS REGARDING AN OFFER OF COMPROMISE TO THE SECURITIES & EXCHANGE COMMISSION ON BEHALF OF THE CITY OF SAN DIEGO.

The City Attorney has engaged in informal discussions with representatives of the US Securities & Exchange Commission about the possibility of the City making an Offer of Settlement to the SEC. The City Attorney requests authority to make such an offer on behalf of the City, without personal prejudice to the Mayor and City Councilmembers. The City would enter into any proposed Offer of Settlement without admitting or denying the findings made by the SEC. The resolution of the SEC proceeding against the City of San Diego would assist KPMG in completing its audit.

As part of its Offer of Settlement, the City of San Diego would undertake to implement more effective policies and procedures regarding its preparation of preliminary official statements about and supervision of related offerings of municipal securities. Among other remedial devices, the City of San Diego would be required to engage an independent consultant, acceptable to the Commission staff, who would have his or her compensation and expenses borne exclusively by the City.

The independent consultant would review and determine the adequacy of the City's policies and procedures to detect and prevent further violations of federal securities laws, and with respect to such policies and procedures, the independent consultant would, within sixty days of his or her appointment recommend the adoption and implementation of any new and/or revised procedures deemed necessary or appropriate; and recommend the adoption and implementation of new and/or revised training program deemed necessary or appropriate.

The independent consultant's recommendation would be made in the form of an Initial Report submitted to the Mayor, City Council, and Commission staff, who would be required to adopt these recommendations in good faith.

The independent consultant would complete the review and submit a written Final Report to the Mayor, City Council, and Commission staff within sixty (60) days of the Initial Report. Within sixty (60) days of the receipt of the Final Report, the Mayor and City Council would file an affidavit with the Commission staff stating either that they have put in place the recommended system of policies and procedures reasonably designed to prevent and/or detect future violations of the securities laws similar to those that gave rise to this Offer of Settlement or that they are in the process of doing so. In this latter case the Mayor and Council would provide a reasonable estimate, not to exceed sixty (60) additional days without the approval of the Commission staff, about when implementation would be completed.²³

RECOMMENDATION NO. 3: THAT THE MAYOR AND CITY COUNCIL AUTHORIZE THE CITY ATTORNEY TO TAKE ALL LEGAL STEPS NECESSARY TO RESCIND ANY AND ALL UNLAWFUL PENSION BENEFITS GRANTED IN VIOLATION OF EITHER CALIFORNIA STATE LAW OR THE SAN DIEGO CITY CHARTER.

The San Diego City Attorney requests the Council to authorize him to take all legal steps necessary to rescind any pension benefits created in violation of either Charter § 99, which prohibits the City, absent a vote of the people, from incurring any indebtedness that would exceed revenues in any year,²⁴ or California Constitution Article XVI § 17(a), which mandates that pension systems be administered in a manner that would assure “prompt delivery of benefits.”²⁵ In addition, the City Attorney requests the Mayor and Council take all legal steps necessary to restore the funding ratio of the pension fund to a level sufficient to meet this mandate.

²³ See, *In re CS First Boston Corp.*, Jerry L. Nowlin and Douglas J. Montague Securities Act Release No. 7498, Exchange Act Release No. 39595, A.P. File No. 3-9535 (29 January 1998).

²⁴ City Charter Section 99: Continuing Contracts – The City shall not incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income the revenue provided for such year unless the qualified electors of the City, voting at an election to be held for that purpose, have indicated their assent as then required by the Constitution of the State of California.

²⁵ California Constitution Article XVI § 17(a).

As described in Interim Reports One and Two, the San Diego Mayor and Council acquiesced to exchanging unfunded pension benefits for the pension board's agreement not to enforce this section of the Constitution. Annuling the illegally granted benefits would substantially reduce the pension fund's negative funding ratio.

(a) ... The retirement board shall also have sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries. The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.²⁶

California case law imposes a requirement of "actuarial soundness" on municipal retirement systems. In *Board of Administration v. Wilson*, 52 Cal. App. 4th 1109 (1997), the California Appellate Court clearly stated that long term funding "in arrears" schemes do not constitute actuarially sound pension systems. *Wilson*, 52 Cal. App. 4th at 1133, 1134, citing *California Teachers Assn. v. Cory*, 155 Cal. App. 3rd 494, 506 (1984).

The 1996 and 2002 Boards of the San Diego City Employees Retirement System (SDCERS) voted to accept less than a normally calculated actuarially requested contribution to the system required to assure prompt delivery of plan benefits and so violated § 17(a) of the State Constitution. The Mayor and Council not only failed to provide a funding source for the benefits bestowed but also offered certain special consideration to certain pension board members to induce their 1996 and 2002 agreements not to enforce the fiduciary protections set forth §17(a). A clear violation of Charter §99, this malfeasance has resulted in an annual indebtedness from 1996 to the present that exceeds the income and revenue provided for such years.

In very practical terms the Mayor's and City Council's unlawful actions were described by Dick Vortmann, a member of both the pension board and the Mayor's Blue Ribbon Committee on City of San Diego Finances:

²⁶ California State Constitution Article 16 § 17(a).

The problem is very simply that the City does not want to pay currently for what they want to give the employees. They clearly are addicted to the "give now, pay later" or "burden the future years' taxpayers" when they no longer have any say in the decision - i.e. the decision being locked down now, with the mandatory bill being paid later.²⁷

This is precisely the behavior that Charter § 99 prohibits. Although the current Mayor and City Council did not start the practice of creating pension benefits and then not funding them, they can put a stop to it and correct past violations of § 99.²⁸

RECOMMENDATION NO. 4: THAT THE MAYOR AND CITY COUNCIL AUTHORIZE THE CITY ATTORNEY TO TAKE ALL LEGAL STEPS NECESSARY TO PLACE THE SAN DIEGO CITY RETIREMENT SYSTEM IN RECEIVERSHIP.

The current SDCERS board has engaged in a pattern of unlawful behavior that ranges from failing to meet their fiduciary duties as set forth in California Constitution Article 16 § 17 to violations of the California Open Meeting Law.²⁹ Under the Board's failed and flawed leadership the pension plan's funding ratio has plummeted to less than 65%. With Board members under federal criminal investigation, the City of San Diego took the extraordinary step of extending indemnification to board members in order to insulate them from legal

²⁷ 24 June 2002 Letter from Richard Vortmann to SDCERS Board Members and Administrators.

²⁸ The specific benefits include, but are not limited to, the DROP program and an increase in the per-year accumulation of pension benefits from 1.45% to 2.50% for general members and from 2.0% for lifeguards, 2.2% for fire, and 2.5% for police to 3.0% across the board. This change allows in excess of 13,000 years of pension credits to be purchased at deep discounts. The San Diego City Attorney proposes that a complete accounting be provided to the Mayor and Council by the pension system receiver as discussed *infra*.

²⁹ See 17 December 2004 letter from San Diego City Attorney to SDCERS boardmembers notifying them of a violation of the California Open Meeting Law in connection with the board's decision to exclude board member Diann Shipione from the 19 November 2004 closed session meeting of the board.

accountability for breaches of their fiduciary duty in connection with creating unlawful benefits.³⁰

If a receiver is not appointed to place the control of the pension system under court supervision, the plan's beneficiaries (city employees) will suffer irreparable harm. An independent receiver, expert in pensions and financial work outs, would be the best person to steer the pension system out of its financial crisis. Because neither the current board nor a replacement board of volunteers is likely to be able to move the system through the difficult administrative changes needed to reform the pension system, the San Diego City Attorney requests that the Mayor and City Council support all legal steps needed to place the SDCERS in receivership, including the appointment of a highly qualified receiver.

RECOMMENDATION NO. 5: THAT THE SAN DIEGO MAYOR AND CITY COUNCIL ADOPT A RESOLUTION CALLING UPON THE SDCERS AND/OR THE SDCERS RECEIVER TO WAIVE ATTORNEY-CLIENT AND CLOSED SESSION CONFIDENTIALITY PRIVILIGES IN ORDER TO PROVIDE ALL REQUESTED DOCUMENTS, MATERIALS AND COMMUNICATIONS TO KPMG, THE US ATTORNEY, THE SEC, AND THE CITY ATTORNEY.

The San Diego Mayor and City Council have waived certain of the City's attorney-client and closed session confidentiality privileges to assist KPMG in completing its audit of the City's 2003 financial statement, and the SEC and US Attorney in completing their investigations.³¹ In a 3 February 2005 letter, KPMG indicated their concern that the pension board had not waived the same privileges, stating that "it does appear . . . that it is essential that the investigations have access to documents and interviews from SDCERS, including, without limitation, such materials as SDCERS may have that are within the scope of the subpoenas we understand were served on it in connection with ongoing government investigations."³²

³⁰ See, 18 November 2002 Council Action approving indemnification of the SDCERS Board of Administration members, Resolution No. R-297335.

³¹ See, 8 February 2005 E-mail from Les Girard to Lori Chapin.

³² 3 February 2005 KPMG letter to the Mayor, City Manager, City Attorney and V&E.

The SDCERS Board has refused to waive the Board's attorney-client or closed session privileges. Such a waiver appears to be in the best interests of the board and the system as a whole, but may not in the personal best interests of those Board members suspected of unlawful conduct.

The waivers of the attorney-client and closed session confidentiality privileges are essential to the completion of the City's audit, without which the City will be unable to return to the municipal capital markets. Because the City's ability to meet its financial obligations is also directly related to the welfare of the pension system, it is in the best interests of both the system and the City that the pension board waive the attorney-client and closed session privileges.

Accordingly, the San Diego City Attorney requests that the San Diego Mayor and City Council adopt a resolution calling upon the SDCERS board to waive its attorney-client and closed session confidentiality privileges. Further, the San Diego City Attorney requests that the San Diego Mayor and City Council take all steps necessary to remove from the SDCERS board any Mayor or Council appointee and any City Manager, City Treasurer, or City Auditor appointee who has voted in opposition to SDCERS' waiving its attorney-client and closed session confidentiality privileges.

RECOMMENDATION NO. 6: THAT THE SAN DIEGO MAYOR AND CITY COUNCIL ADOPT A RESOLUTION CALLING UPON THE SDCERS BOARD TO COMPLY WITH THE CITY ATTORNEY'S REINSTATEMENT AS THE LEGAL COUNSEL FOR SDCERS.

The San Diego employees retirement system and its board of administration were created as an entity under the San Diego City Charter. The pension system was created by the City Council under San Diego City Charter § 141, which states that "[t]he Council of the City is hereby authorized and empowered by ordinance to establish a retirement system" and the Board of Administration was created under Charter § 144.³³

³³ Section 144: Board of Administration. The system shall be managed by a Board of Administration which is hereby created, consisting of the City Manager, City Auditor and Comptroller, the City Treasurer, three members of the Retirement System to be elected by the active membership, one retired member of the retirement system to be elected by the retired membership, an officer of a local bank, and three other citizens of the City, the latter four to be appointed by the Council.

San Diego City Charter § 40 designates the San Diego City Attorney as the legal counsel for SDCERS and for all other City departments: “The City Attorney shall be the chief legal adviser of, and attorney for the City and all Departments and offices thereof in matters relating to their official powers and duties.” [Emphasis added.] In 1997, despite the fact that the San Diego City Attorney had historically served as legal counsel to the pension board, former City Attorney Casey Gwinn delegated this duty to counsel employed directly by the Board of Administration.³⁴

On 15 December 2004, the San Diego City Attorney revoked and withdrew that delegation and reasserted the City Attorney’s authority to act as legal counsel to the retirement board.³⁵ However, the board has refused to comply with this action, thus flouting the Charter provisions that designate the City Attorney as the board’s legal counsel. This refusal demonstrates that the board continues to engage in unlawful activity.

The board has now sued the City over this very issue. This lawsuit is an abuse of governmental power.

The San Diego City Attorney requests that the San Diego City Mayor and Council adopt a resolution supporting the San Diego City Attorney’s role as counsel to the San Diego pension system.

RECOMMENDATION NO. 7: THAT THE SAN DIEGO MAYOR AND CITY COUNCIL AUTHORIZE THE CITY ATTORNEY TO PREPARE ORDINANCES AND RESOLUTIONS NECESSARY TO THE CREATION OF A CITY COUNCIL AUDIT COMMITTEE.

Pursuant to the Sarbanes-Oxley Act, the SEC issued an order requiring publicly traded corporations to establish independent audit committees as of 25 April 2003.³⁶ In order to provide effective oversight of the City’s financial

³⁴ 22 July 1998 MOU between San Diego City Attorney Casey Gwinn and SDCERS.

³⁵ 15 December 2004 letter from City Attorney Michael J. Aguirre to Lawrence Grissom.

³⁶ See, Section 10A(m)(1) of the Securities Exchange Act of 1934, as added by See, Exchange Release Nos. 33-8220; 34-47654; IC-26001 (File No. S7-02-03) discussing the required role of audit committees in the private corporation context under the new SEC rules.

reporting process and to avoid a recurrence of the underlying financial problems, the San Diego City Attorney recommends that the Mayor and City Council create an audit committee to mirror the role such committees play in public corporations:

Effective oversight of the financial reporting process is fundamental to preserving the integrity of our markets The audit committee ... plays a critical role in providing oversight over and serving as a check and balance on a [City's] financial reporting system. The audit committee provides independent review and oversight of a [city's] financial reporting processes, internal controls and independent auditors. It provides a forum separate from management in which auditors and other interested parties can candidly discuss concerns. By effectively carrying out its functions and responsibilities, the audit committee helps to ensure that management properly develops and adheres to a sound system of internal controls, that procedures are in place to objectively assess management's practices and internal controls, and that the outside auditors, through their own review, objectively assess the company's financial reporting practices.³⁷

The City of San Diego Audit Committee would consist of three Councilmembers and two public members with audit training. Again, the Committee would base its organization to the fullest extent possible on the public corporate model:

- Each member of the audit committee of the issuer must be independent according to specified criteria;
- The audit committee ... must be directly responsible for the appointment, compensation, retention and oversight of the work of [its independent] public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the [City] and [the City's independent auditor would] report directly to the audit committee;
- [The] audit committee must establish procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting

³⁷ See, Section 10A(m)(1) of the Securities Exchange Act of 1934, as added by Section 301 of the Sarbanes-Oxley Act of 2002; Exchange Release Nos. 33-8220; 34-47654; IC-26001; File No. S7-02-03.

controls or auditing matters, including procedures for the confidential, anonymous submission by employees of the [City] of concerns regarding questionable accounting or auditing matters;

- [The] audit committee must have the authority to engage independent counsel and other advisors, as it determines necessary to carry out its duties; and
- [The City] must provide appropriate funding for the audit committee.³⁸

RECOMMENDATION NO. 8: THAT THE SAN DIEGO MAYOR AND CITY COUNCIL AUTHORIZE THE CITY ATTORNEY TO PREPARE ORDINANCES AND RESOLUTIONS NEEDED TO CREATE A PENSION REGULATORY COMMISSION AND TO ESTABLISH RELATED PENSION REGULATION REFORMS.

The San Diego City Attorney recommends that the City establish the City of San Diego Pension and Benefit Regulatory Commission (the Pension Commission) modeled on the standards, procedures, and enforcement of the federal Employee Retirement Income Security Act (ERISA). Pursuant to this recommendation, the Pension Commission would be an independent regulatory arm, which, although modeled on ERISA, would confer even greater rights not only on the City and its taxpayers but also on pension beneficiaries. Oversight by the Pension Commission would preclude the pension plan abuses identified in the City Attorney's Interim Report No. 2 from recurring.

The Pension Commission would establish reporting requirements and enforcement policies to investigate and correct:

Any failure of fiduciaries to operate the plan prudently and for the exclusive benefit of participants;

Any use of plan assets to benefit certain related parties in interest to the plan, including the plan administrator, the plan sponsor, and parties related to these individuals;

³⁸ See, Section 10A(m)(1) of the Securities Exchange Act of 1934, as added by Section 301 of the Sarbanes-Oxley Act of 2002; Exchange Release Nos. 33-8220; 34-47654; IC-26001; File No. S7-02-03.

Any failure either to properly value plan assets at their current fair market value or to hold plan assets in trust;

Any failure to make benefit payments, either pension or welfare, due under the terms of the plan;

Any adverse action--e.g., being fired, fined, or otherwise discriminated against--taken against any trustee or beneficiary for exercising his or her rights under the plan.³⁹

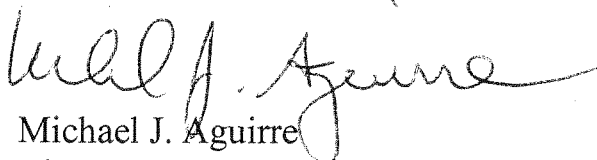
III.

CONCLUSION

The San Diego City Attorney's Office is proposing this eight-step legal action plan to address the legal and financial crisis facing the City of San Diego. This plan is offered as an alternative to the City's seeking reorganization under Chapter 9 of the U.S. Bankruptcy Code. In the considered judgment of the City Attorney's Office, the immediate implementation of this plan by the Mayor and City Council will advance the City's financial recovery and hasten the reentry of the City into the municipal securities markets.

MICHAEL J. AGUIRRE, City Attorney

By



Michael J. Aguirre
City Attorney

MJA:meb

cc: City Manager P. Lamont Ewell

³⁹ See, U.S. Department of Labor Employee Benefits Security Administration's Website.

**CITY ATTORNEY MICHAEL AGUIRRE'S
LEGAL ACTION PLAN TO ADDRESS CITY'S FINANCIAL CONDITION
Memorandum to Mayor and City Council delivered on February 22, 2005**

Recommendation No. 1: That the Mayor and City Council conditionally accept on behalf of the City of San Diego the materials and findings contained in San Diego City Attorney's First and Second Interim Reports.

Recommendation No. 2: That the Mayor, City Council, and outside counsel Vinson & Elkins authorize the San Diego City Attorney to engage in negotiations regarding an offer of compromise to the Securities & Exchange Commission (SEC) on behalf of the City of San Diego.

Recommendation No. 3: That the Mayor and City Council authorize the City Attorney to take all legal steps necessary to rescind any and all unlawful pension benefits authorized in violation of either California State Law or the San Diego City Charter.

Recommendation No. 4: That the Mayor and City Council authorize the City Attorney to take all legal steps necessary to place the San Diego City Retirement System (SDCERS) in receivership.

Recommendation No. 5: That the Mayor and City Council adopt a resolution calling upon the SDCERS and/or the SDCERS receiver to waive attorney-client and closed session confidentiality privileges in order to provide all requested documents, materials, and communications to KPMG, the U.S. Attorney, the SEC, and the City Attorney.

Recommendation No. 6: That the Mayor and City Council adopt a resolution calling upon the SDCERS Board to comply with the City Attorney's reinstatement as the legal counsel for SDCERS.

Recommendation No. 7: That the Mayor and City Council authorize the City Attorney to prepare ordinances and resolutions necessary for the creation of a City Council Audit Committee.

Recommendation No. 8: That the Mayor and City Council authorize the City Attorney to prepare ordinances and resolutions necessary for the creation of a Pension Regulatory Commission to establish related pension regulation reforms.

Aguirre's 'road map' for S.D. | Mayor calls city attorney 'rookie' over legal advice

[1,2,6,7 Edition]

The San Diego Union - Tribune - San Diego, Calif.

Author: Matthew T. Hall

Date: Feb 23, 2005

Section: LOCAL

Text Word Count: 1271

Document Text

Editions vary | For charts see end of text.

City Attorney Michael Aguirre used a 4 p.m. news conference yesterday to unfold a "road map" of eight recommendations for a City Council he said has failed to lead San Diego past financial problems and federal probes.

Three hours later, Mayor Dick Murphy held his own news conference to say Aguirre is a "rookie" who would only get the city lost in costly litigation.

"I say to Mr. Aguirre, you either join the team or sit on the bench," Murphy said.

The dueling news conferences showed none of the cooperation that Fitch Ratings called essential last week when it downgraded San Diego's credit rating and blamed political strife for slow progress on the city's financial woes.

San Diego has a \$1.37 billion pension deficit, two overdue fiscal audits and a broken ability to borrow money, which is delaying fire stations and sewer projects.

"This is a very solvable problem, and all that we're missing, the only missing piece, is that we haven't had the leadership from our mayor and City Council," Aguirre said. "They now have their road map, and the question is, will they adopt this road map or will they continue to duck and not step up to the plate and not have the political courage to do what needs to be done?"

Aguirre's ideas include putting San Diego's troubled pension system in receivership, rolling back employee pension benefits to 1996 levels and letting him negotiate a settlement in a Securities and Exchange Commission investigation.

He also wants the council to accept his findings in two reports into possible abuse, fraud and illegal acts by city officials, including one in which he accused Murphy and most of the council of civil violations of federal securities laws.

No way, Murphy said, repeating a comment from two weeks ago that Aguirre's allegations were "untrue, irresponsible and defamatory."

"We have the foremost authority on municipal disclosure in America representing us (before the SEC)," Murphy added. "Why would we hand that over to a rookie like Mr. Aguirre?"

Putting the pension system in receivership "would certainly tie up the city in years of expensive litigation," the mayor said. "We've already got one lawsuit filed as a result of this feud between Mr. Aguirre and the retirement board. I don't think we need any more."

Aguirre first talked of suing to oust the pension board and put the \$3.6 billion San Diego City Employees Retirement System into receivership Jan. 27, the day the pension board filed a lawsuit in Superior Court to stop Aguirre from asserting control over the system as the city's top lawyer.

Yesterday, Frederick Pierce IV, president of the retirement board since 2000, called Aguirre's recommendations "an illegal attempt to do a hostile takeover of the city and retirement system."

Judie Italiano, president of the 6,000-member Municipal Employees Association, the city's largest union, also said Aguirre was going too far.

"I don't think you can go back and rewrite history on this," she said. "He's just opening up the city to lawsuits that it can ill afford right now."

Aguirre is asking the City Council to authorize him to "take all legal steps necessary to rescind any and all unlawful pension benefits" that he said violate the city charter and state law.

He said rolling back those pension benefits would reduce the system's deficit by hundreds of millions of dollars, but his idea wasn't included as part of the initial contract offer the City Council made to its four labor unions last week.

Labor negotiations are expected to begin soon for new contracts to replace the ones that expire June 30.

City Manager Lamont Ewell said Aguirre supported the council's contract offer last week and shouldn't work at cross purposes now.

"At some point, Mr. Aguirre needs to agree that he wants to be part of the solution and not continue to make agreements and then turn around and do something opposite," Ewell said.

Aguirre said the City Council is scheduled to discuss the SEC investigation in closed session next week and that he hopes most of the other matters will be taken up by the council at an open meeting a week later.

He said he would proceed on his plans to ask a Superior Court judge to place the pension system into receivership regardless of whether the council supports the step.

Aguirre acknowledged that the pension board will be completely overhauled with new members by April, but he said the new appointees would be "part of the same political process."

Seeking court intervention this way "gives you many of the advantages of bankruptcy, but it doesn't give you the stigma or the disadvantages of bankruptcy," Aguirre said.

Under federal law, cities, counties and other municipalities that can't pay their bills can file for bankruptcy for an automatic stay on their debts. With a receivership, a judge would appoint a receiver to manage a system that otherwise would face unavoidable harm.

"What you're basically doing is saying there's been a breakdown in the management, there's been a breakdown in the operation of the pension plan," he said.

If his proposals are rejected, Aguirre added, "We may have to resort to bankruptcy."

City attorney's plan

San Diego City Attorney Michael Aguirre yesterday outlined an eight-step plan for the City Council to resolve a pension crisis marked by a \$1.37 billion deficit, two overdue financial audits and federal investigations into city finances. The recommendations are:

- o Agree to let Aguirre take legal action to place the San Diego City Employees Retirement System in receivership.
- o Authorize Aguirre to negotiate a settlement with the Securities and Exchange Commission, if the city's outside counsel agrees.
- o Direct Aguirre to file a lawsuit to rescind "any and all unlawful pension benefits" that violate state law or the city charter.
- o Adopt a resolution calling on the pension system or its receiver to waive attorney-client and closed-session confidentiality privileges and provide all information to the city's outside auditor, KPMG; the U.S. attorney; the SEC; and Aguirre.
- o Accept Aguirre's findings in two reports on possible abuse, fraud and illegal acts by city officials without admitting personal guilt.
- o Adopt a resolution calling on the pension board to allow Aguirre to be its legal counsel.
- o Authorize Aguirre to propose a new City Council Audit Committee.

o Authorize Aguirre to propose a new Pension Regulatory Commission to establish related pension regulation reforms.

Receivership vs. bankruptcy

City Attorney Michael Aguirre has proposed putting San Diego's pension system into receivership rather than bankruptcy. Receivership: The Superior Court would be asked to appoint a receiver to take temporary control of the financially strapped system from the pension board. Bankruptcy: A bankruptcy filing, permitted if the system cannot pay its bills, allows extending the time for paying debts, reducing the principal or interest on the payments or refinancing the debts through new loans.

Matthew Hall: (619) 542-4599; matthew.hall@uniontrib.com

[Illustration]

4 PICS | 2 CHARTS; Caption: 1. Mayor Dick Murphy said Aguirre can "either join the team or sit on the bench." (Ed. 7) 2. "We haven't had the leadership," said City Attorney Michael Aguirre of city officials. (Eds. 1,7) 3. Mayor Dick Murphy, smiling for the cameras after his own news conference, said Aguirre's "road map" would lead to lawsuits against the city. (Eds. 1,6,7) 4. City Attorney Michael Aguirre (left), with two of his deputies, detailed his eight-point plan for solving San Diego's financial problems yesterday. 5. City attorney's plan 6. Receivership vs. bankruptcy (Eds. 1,6,7); Credit: 3. Earnie Grafton / Union-Tribune 4. Sean M. Haffey / Union- Tribune

Credit: STAFF WRITER

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.

Abstract (Document Summary)

[Michael Aguirre] first talked of suing to oust the pension board and put the \$3.6 billion San Diego City Employees Retirement System into receivership Jan. 27, the day the pension board filed a lawsuit in Superior Court to stop Aguirre from asserting control over the system as the city's top lawyer.

4 PICS | 2 CHARTS; 1. Mayor [Dick Murphy] said Aguirre can "either join the team or sit on the bench." (Ed. 7) 2. "We haven't had the leadership," said City Attorney Michael Aguirre of city officials. (Eds. 1,7) 3. Mayor Dick Murphy, smiling for the cameras after his own news conference, said Aguirre's "road map" would lead to lawsuits against the city. (Eds. 1,6,7) 4. City Attorney Michael Aguirre (left), with two of his deputies, detailed his eight-point plan for solving San Diego's financial problems yesterday. 5. City attorney's plan 6. Receivership vs. bankruptcy (Eds. 1,6,7); Credit: 3. Earnie Grafton / Union-Tribune 4. Sean M. Haffey / Union- Tribune

Reproduced with permission of the copyright owner. Further reproduction or distribution is prohibited without permission.



San Diego City Attorney **MICHAEL J. AGUIRRE**

NEWS RELEASE

FOR IMMEDIATE RELEASE: March 1, 2005

Contact: Maria Velasquez, Communications Director: (619) 235-5725 (pager & voicemail) mvelasquez@sandiego.gov

MAYOR AND CITY COUNCIL VIOLATE CHARTER; ATTEMPT TO INTERFERE WITH CITY ATTORNEY AUTHORITY TO REPRESENT CITY'S RETIREMENT BOARD Former Political Opponent of City Attorney Hired by City Manager

San Diego, CA: The Mayor and certain members of the City Council, working through the City Manager, have hired private attorney Paul Pfingst to issue an opinion in closed session today that the Mayor and Council can circumvent the City Charter provision that assigns to the people of San Diego the power to decide who represents the City in litigation. Under their plan, the Mayor and Council would hire outside counsel and not the City Attorney to defend the City against the San Diego City Employees' Retirement System (SDCERS) suit to block the City Attorney from acting as the SDCERS lawyer.

Last month, the outgoing SDCERS Board sued the City and City Attorney to stop the City Attorney from becoming their lawyer. According to the City Attorney, by refusing to support the City Attorney's efforts to restore the Office of the City Attorney as counsel for SDCERS, the Mayor and Council are serving to delay the progress of the federal investigation into the City's pension fund and related finances.

"The Mayor and certain members of the council are thwarting the will of the voters and aiding those who are responsible for the pension fraud and massive deficit facing the City," said City Attorney Michael Aguirre.

Paul Pfingst has stated that he will opine that Municipal Code Section 24.0910 is quite clear in its affirmation that the City Attorney is the legal advisor to the SDCERS Board. Pfingst claims the City Council actually *intended* to take the representation of the SDCERS Board away from the City Attorney, although the Council approved an ordinance that said exactly the opposite. There is no legal basis for the ridiculous opinion of Mr. Pfingst. Municipal Code Section 24.0910 provides clearly that the City Attorney designates the lawyers for the Board:

"Unless otherwise provided by Memorandum of Understanding between the City Attorney and the Board of Administration, the City Attorney will designate one or more Deputy City Attorneys to advise and represent the Board in the administration of the System." *San Diego Municipal Code Section 24.0910.*

(MORE)

e City Attorney is Required to Represent the City's Legal Interests:

The San Diego City Charter provides that the City Attorney "shall be the chief legal advisor of, and attorney for the City and all Departments and offices thereof" and has a duty and right to "prosecute and defend, as the case may be" all suits in which the City is a party. *San Diego City Charter Section 40* (emphasis added).

The City Attorney's responsibility to represent City agencies and departments is absolute, and includes the representation of the SDCERS Board. In fact in April 2002, the City Council amended the Municipal Code and reaffirmed the City Attorney's jurisdiction over the SDCERS Board.

Even though the prior City Attorney, Casey Gwinn, entered into a Memorandum of Understanding (MOU) with the SDCERS board on July 22, 1998, Mr. Gwinn was firm in his resolve that:

"This determination does not constitute an admission against the City's interest nor a waiver of the City Attorney's position regarding his rights and responsibilities to the Retirement System under section 40 of the City Charter." (emphasis added).

On December 15th, 2004, immediately after taking office, Mr. Aguirre revoked Mr. Gwinn's MOU of July 22, 1998 by letter to the Chair of the SDCERS Board. As all prior MOUs between the Retirement Board and the City Attorney's Office are no longer in effect, the City Attorney's Office remains, by law, the appointing and controlling authority of the Deputy City Attorneys who work for the Board.

According to City Attorney Aguirre, the City Attorney's Office has spent numerous hours working on this case and has the expertise to handle the lawsuit in-house. Hiring outside counsel is both unnecessary and expensive. The Mayor and the City Council do not have the authority under the City Charter, to take this unilateral action. The authority is granted solely to the City Attorney.

SDCERS Lawsuit Background:

SDCERS Board retained outside counsel, Seltzer Caplan McMahon & Vitek, without the permission of the City Attorney. The (SDCERS) Board asserts that it no longer must follow the City Charter and Municipal Code and may hire any attorney it wishes, without any oversight or review. No Memorandum of Understanding (MOU) regarding these outside lawyers exists or was agreed to by the City Attorney.

Pfingst Background

Mr. Pfingst is Mr. Aguirre's former political opponent whom Mr. Aguirre ran against in 2002 for District Attorney. He is also a television legal commentator who has been openly critical of Mr. Aguirre.

"Paul Pfingst, who was removed from office for unethical behavior by San Diego voters and was caught using drugs while a New York prosecutor, is hardly suited to provide independent and reliable advice to the Mayor and City Council," said City Attorney Aguirre.

###